

Municipal Bank Feasibility Task Force Report

Treasurer José Cisneros

San Francisco Office of the
Treasurer & Tax Collector
March 2019

ACKNOWLEDGMENTS

The Treasurer would like to thank the members of the Municipal Bank Feasibility Task Force who graciously gave their time and energy to this process and this report:

John Avalos, Ada Chan, James Clark, Marc Franson, Paulina Gonzalez-Brito, Kate Hartley, Sushil Jacob, Jim Lazarus, Lauren Leimbach, Ben Mangan, Ky-Nam Miller, Tim Schaefer, Nadia Sesay, Kat Taylor, Steve Zuckerman

Staff: Molly Cohen, Amanda Fried and Tajel Shah
Technical Consultant: Katherine Chen



Table of Contents

Executive Summary	3
Introduction.....	11
About the Task Force	13
Bank Basics.....	15
Municipal Bank Primer	16
Municipal Bank Models	18
What Are the Policy & Operational Considerations Around Forming a Bank?	35
Conclusion: A Phased Approach and Next Steps	44
Appendix A: BOS Resolution.....	49
Appendix B: Detailed Description of Lines of Business	55
Appendix C: Current City-Funded Programs in Affordable Housing, Small Business Lending & Infrastructure	60
Appendix D: Technical Appendix	65
Appendix E: Letters from Task Force Members.....	99

Executive Summary

The goal of this report is to provide thoughtful analysis of the financial costs and benefits of creating a municipal bank and to outline the policy and operational considerations should the City choose to proceed. A municipal bank presents an opportunity to achieve community goals, such as divestment and reinvestment, in a sustainable and creative fashion. However, it is also a time-intensive and expensive endeavor. Pursuing a municipal bank has significant short-term costs, in terms of money, time and energy. It also has a significant, but uncertain, pay-out in the long-term. Creating a public bank necessarily involves making difficult decisions around trade-offs about how the City should prioritize projects and allocate its money.

This report is the culmination of the Municipal Bank Feasibility Task Force (“Task Force”) process. Treasurer José Cisneros selected members of the Task Force in 2017 to research the viability and advisability of a municipal bank as well as other opportunities to leverage the City’s banking and investment practices to promote community goals. The formation of the Task Force was recommended by the Board of Supervisors in resolution 152-17 to “advise the Treasurer... the Mayor, the Board of Supervisors and relevant City Departments regarding the creation of a Municipal Public Bank.”

The report’s analysis is intended to build on the research of the San Francisco Budget & Legislative Analyst, and several recent reports on municipal banking that do an excellent job outlining the policy reasons why a jurisdiction might choose to create a municipal bank. This report seeks to offer concrete figures as well as potential alternatives to a municipal bank to

inform and bolster that dialogue. This report provides three financial models for a municipal bank: a reinvestment entity that focuses on affordable housing and small business lending to achieve community goals, a divestment bank that performs the City’s cash management, and a combination bank that performs both the City’s cash management and affordable housing and small business lending. For all these models, the Task Force did not specify where the funds would come from to support start-up and operations, though they recognized that General Fund appropriations would likely be critical to the banks’ success.

Aside from these three municipal bank models, the report also outlines policy considerations associated with starting a municipal bank, such

This report provides three financial models for a municipal bank: a reinvestment entity that focuses on affordable housing and small business lending to achieve community goals, a divestment bank that performs the City’s cash management, and a combination bank that performs both the City’s cash management and affordable housing and small business lending.

as potential sources of funds for capitalization, start-up costs and deposits. The report also includes other interim or alternative options that could achieve similar aims as a municipal bank and concludes with next steps the City could take should it choose to move forward with creating a municipal bank.

This report does not opine on whether a

municipal bank, or a particular municipal bank model, is the right option for the City, but rather, seeks to provide enough specifics to guide future policy decisions by the Board of Supervisors and the Mayor. This report seeks to

inform the dialogue around municipal banking by offering concrete figures regarding the endeavor.

1 Model One: Reinvest

Model One, the first municipal bank model, is focused on lending and reinvestment in areas that are underserved by the traditional banking industry. After significant deliberation and prioritization, the Task Force chose to focus on affordable housing and small business lending as top community goals for the reinvestment model. Model One is not designed to perform the City's cash management and commercial banking functions. This model would not require a bank charter or deposit insurance, because the bank would not accept deposits or serve as the City's banker, but it would need similar capitalization to a traditional bank.

With \$1 billion in loans, the municipal bank will be able to bring \$1 billion in investment to bear, making 170 affordable housing loans, 60 wholesale small business loans (which will result in numerous small business loans), and 700 direct small business loans. The City currently invests \$400 million per year in affordable housing. At \$1 billion in loans, the municipal bank would add another \$850 million in lending that would revolve on average every three-to-five years, resulting in an additional \$200 million investment in affordable housing per year. For small business lending, the bank would add \$125 million in wholesale loans and \$25 million for 700 in direct loans compared to the approximately 50 loans for a total of \$50 million currently issued by the City's Small Business Revolving Loan Fund and Emerging Business Loan Fund.

To achieve financial sustainability, Model One must be approximately \$1.1 billion in size with \$165 million in bank capital. The model projects it will take around 10 years to achieve a surplus (by comparison the low-end estimate projects a surplus after 5 years, and the high-estimate never achieves a surplus). In the first 9 years, the bank will need \$13 million in subsidies to maintain operations (ranging from a low of \$4 million and a high of a continuous subsidy throughout operations that can reach \$42 million per year due to high losses from direct small business lending). The start-up and operational costs for Model One are lower than those for Model Two and Three, because Model One will not need to develop and maintain infrastructure to serve as the City's banker and will have lower compliance and regulatory costs. The bank will also need 15 percent of its assets held as bank capital. At \$1.1 billion this figure is \$165 million, and it will increase as the bank gets larger. Model One cannot accept deposits so it will need to secure higher-cost debt to serve as lending principal.

MODEL 1: REINVEST

Table 1: Model One Lending Lines of Business at \$1 Billion in Loans

	Loan Assets at \$1B (\$MM)	Percent of Loans at \$1B	Number of Loans at \$1B	Average Size of Loan	Average Interest Rate	Estimated Loss Rate (Low-High)	Average Loan Term
Real Estate Lending (ADU, mezzanine debt, small sites)	850	85%	170	\$5,000,000	5%	1-2%	3-5 years
Wholesale Small Business Lending	125	12.5%	60	\$2,000,000	2.5%	0.5-1%	5 years
Direct Small Business Lending	25	2.5%	700	\$35,000	15%	15-30%	3-5 years

Table 2: Estimated Range of Costs Associated with Model One

Cost Type	Average Cost	Low and High Cost Estimates	Description	Timeframe
Size at annual breakeven	\$1.1 billion	\$330 million – never	Estimated asset size for bank to breakeven	–
Start-up costs	\$6.25 million	\$5 million – \$7.5 million	Cost for staffing, real estate, technology infrastructure	Approximately 2 years before operations
Balance sheet capital at annual breakeven	\$165 million	\$50 million – never	Capital equivalent to 15% of assets at breakeven	Year 1+ until operation ceases

2 Model Two: Divest

The primary goal of Model Two, the divest model, is to create a public bank that can take over the City’s cash management and commercial banking functions currently performed by Bank of America and U.S. Bank. Model Two would hold and manage the \$100 million currently held in the City’s short-term accounts used for daily transactions. The bank would provide disbursements, deposits, cash management, payment processing, and financial reporting and technology solutions for the approximately \$13 billion that cycles through the City’s accounts on a yearly basis. For a sense of the scale of this work, this bank would be responsible for handling the 1.2 million checks deposited per year by the City, the 323,000

\$600,000 for this work, equivalent to the fees currently paid to Bank of America. The bank would perform participation lending, purchasing loans originated by other banks and credit unions, to make a profit and subsidize the cash management operations of the bank. At \$1 billion in loans, it could offer 200 loans at \$5 million each.

To achieve financial sustainability, Model Two must be \$3.1 billion in size with \$460 million in bank capital. The model projects it will take around 31 years to break even operationally for the year (the low-estimate projects a surplus after 25 years, and the high-estimate projects 37 years). In the first 30 years, the model estimates

the bank will need \$990 million in subsidies to maintain operations until it can break even and achieve a surplus (with estimates ranging from \$580 million to \$1.5 billion). The bank will also need to hold capital equivalent to 15 percent of assets – at least \$165 million at \$1.1 billion in assets and increasing from there. The bank will also need a deposit base

equivalent to the size of the bank assets less bank capital, so, for example at \$1.1 billion in assets and \$1 billion in loans, the bank will need to secure \$935 million in deposits to perform its lending.

This bank would be responsible for handling the 1.2 million checks deposited per year by the City, the 323,000 credit card transactions, and 847,000 outgoing payments per year.

credit card transactions, and 847,000 outgoing payments per year. Given the scale of the City and the number of transactions per year, the cash management work would be complex and costly. The bank would charge the City

Table 3: Model Two Lending Lines of Business at \$1 Billion in Loans

Lines of Business	Loan Assets at \$1B (\$MM)	Percent of Portfolio at \$1B	Number of Loans at \$1B	Average Size of Loan	Interest Rate	Loss Rates	Average Loan Term
Participation Lending	1,000	100%	200	\$5,000,000	4%	0.5%	17 years

MODEL 2: DIVEST

Table 4: Estimated Range of Costs Associated with Model Two

Cost Type	Average Cost	Low to High Cost Estimates	Description	Timeframe
Size at annual breakeven	\$3.1 billion	\$2.3 billion – \$4.1 billion	Estimated asset size for bank to breakeven	–
Start-up costs	\$119 million	\$95 million – \$143 million	Cost for staffing, real estate, technology infrastructure	Approximately 2 years before operations
Balance sheet capital at annual breakeven	\$460 million	\$340 million – \$615 million	Capital equivalent to 15% of assets at breakeven	Year 1+ until operation ceases

3 Model Three: Combination

Model Three is a combination of Models One and Two. It is a municipal bank that accepts deposits, performs the City’s cash management and commercial banking, as well as affordable housing and small business lending. Model Three will not perform retail banking for customers. Model Three will allow the City to both divest from commercial banking partners and perform reinvestment lending. As in Model One, at \$1 billion in loans, the municipal bank will make 170 affordable housing loans, 60 wholesale small business loans (which will result in numerous small business loans), and 700 direct small business loans. As the bank scales up, the magnitude of its investment in the community will similarly scale.

To achieve financial sustainability, Model Three must be \$10.4 billion in size with \$1.6 billion in bank capital. The model projects it will take around 56 years to break even operationally for the year (the low-estimate projects a surplus in 36 years, and the high-estimate never achieves a surplus). During these years of losses, the bank will need an average \$2.2 billion in subsidies to maintain operations until it can break even (with estimates ranging from \$980 million to a continuous \$78 million per year subsidy). The bank will also need a deposit base equivalent to the size of the bank assets less bank capital, so, for example at \$1.1 billion in assets and \$1 billion in loans, the bank will need to secure \$935 million in deposits to perform its lending.

MODEL 3: COMBINATION

Table 5: Model Three Lending Lines of Business at \$1 Billion in Loans

	Loan Assets at \$1B (\$MM)	Percent of Loans at \$1B	Number of Loans at \$1B	Average Size of Loan	Average Interest Rate	Estimated Loss Rate (Low-High)	Average Loan Term
Real Estate Lending (ADU, mezzanine debt, small sites)	850	85%	170	\$5,000,000	5%	1-2%	3-5 years
Wholesale Small Business Lending	125	12.5%	60	\$2,000,000	2.5%	0.5-1%	5 years
Direct Small Business Lending	25	2.5%	700	\$35,000	15%	15-30%	3-5 years

Table 6: Estimated Range of Costs Associated with Model Three

Cost Type	Average Cost	Low and High Cost Estimates	Description	Timeframe
Size at annual breakeven	\$10.4 billion	\$3.9 billion – never	Estimated asset size for bank to breakeven	–
Start-up costs	\$119 million	\$95 million – \$143 million	Cost for staffing, real estate, technology infrastructure	Approximately 2 years before operations
Balance sheet capital at annual breakeven	\$1.6 billion	\$590 million – never	Capital equivalent to 15% of assets at breakeven	Year 1+ until operation ceases

Comparison

All three bank models must grow to a large size to break even and all would require significant subsidy and capital investment, though the amounts vary significantly from model to model. Model One, which has reduced start-up and operational costs because it does not need a bank charter or infrastructure to perform the City’s commercial banking, requires the least time and investment to break even. It will break even after 10 years and a total estimated \$184 million in investment – \$165 million in capital, and \$19 million in start-up cost and subsidies.

In contrast, Model Two will break even after 31 years and \$1.6 billion investment, and Model Three will break even after 56 years and \$3.9 billion in investment. It is important to note that the length of time a model projects for annual bank breakeven depends on a variety of factors such as expenses, revenue, and growth rates. Adjusting any of these levers can shorten or lengthen the time it takes for the bank model to break even for the year for the first time.

Table 7: Average Investment Required for Municipal Bank Models to Break Even¹

	Model One: Reinvest	Model Two: Divest	Model Three: Combination
Break Even Details			
Years to Break Even	10	31	56
Size at Breakeven	\$1.1 billion	\$3.1 billion	\$10.4 billion
Estimated Appropriation Required to Break Even			
Start-Up Costs	\$6 million	\$119 million	\$119 million
Operational Subsidy	\$13 million	\$990 million	\$2.2 billion
Capital Investment	\$165 million	\$460 million	\$1.6 billion
Total	\$184 million	\$1.6 billion	\$3.9 billion

¹ These figures are estimated based on bank models and are the average of the low- and high-estimate scenarios.

Alternatives

The City could also consider alternative or interim policies and programs that could achieve similar aims as a municipal bank. These initiatives could be aimed at various outcomes and be accomplished via programming, the power of purchasing and contracting, and participating with other legislative and public banking efforts. Opportunities include:

- Expand socially responsible banking indicators in the City's banking RFP
- Investigate opportunities to break up the City's banking RFP
- In-source mail and check processing from commercial banking partners
- Advocate for banking sector reforms
- Expand Safe, Sound and Local
- Create non-bank lending programs
- Better publicize existing small business lending programs and CDFIs
- Promote and expand the Bank On Program
- Advocate for youth bank accounts
- Expand Smart Money Coaching efforts

Introduction

Across the country, there is a surge of interest in public banking and the formation of new public banks. Public banks are financial institutions owned by any public government entity including nation, state, county, municipality, or agency. Rather than solely serving shareholders, public banks seek to achieve community goals and return profits to people and benefits back to the community. In recent years, jurisdictions around the country, including Massachusetts, Washington, Oakland, Santa Fe, Washington D.C. and Seattle have embarked on feasibility studies of public banking.

In April 2017, the City and County of San Francisco (the "City") Board of Supervisors passed a resolution, urging "the Office of the Treasurer & Tax Collector to convene a task force, and the City Attorney to advise the Treasurer in this effort, for the purpose of advising the Mayor, the Board of Supervisors, and relevant City Departments regarding the creation of a Municipal Public Bank, either as a new City Department or a separate Enterprise Department."² Based on this Resolution, the Office of Treasurer & Tax Collector ("TTX"), led by Treasurer José Cisneros, convened the Municipal Bank Feasibility Task Force ("Task Force") to investigate the potential costs and benefits of a municipal bank as well as other opportunities to leverage the City's banking and investment practices to support community development.

The Task Force builds on work that the Treasurer has done previously to improve our City's banking operations, and to strengthen economic security for all San Franciscans. For example:

- Creating a ground-breaking program, Bank On San Francisco, in 2006 that helped

unbanked San Franciscans get access to low-cost checking accounts and has been replicated across the country through the Bank On national program.

- Including socially-responsible banking criteria as part of the bid and evaluation process in the 2011 RFP for banking services.
- Battling check cashers and encouraging local businesses to move towards direct deposit and other modern innovative payroll solutions.
- Launching the Kindergarten to College program in 2011 which opens a free and automatic college savings account for all incoming San Francisco public school kindergarteners and seeds it with \$50.
- Proactively taking a stand against Wells Fargo – the first Treasurer in the nation to do so – in the aftermath of the news that the bank engaged in widespread illegal practices around account openings.
- Creating the Smart Money Coaching program which offers free one-on-one financial coaching.
- Offering Summer Jobs Connect, which provides youth with credit union accounts and financial education.
- Creating a new investment opportunity with local financial institutions called Safe, Sound and Local, which makes up to \$80 million per year of the County's Pooled Investment Fund available for investments in banks, credit unions and community development financial institutions (CDFIs) located in San Francisco that are backed by letters of credit issued by the Federal Home Loan Bank of San Francisco.

The Task Force brings together advocates working to improve access to credit for low-income, communities of color; finance professionals with years of experience in traditional consumer banks, credit unions and

² City and County of San Francisco Board of Supervisors. Resolution 152-17. Retrieved from: <http://sfbos.org/sites/default/files/r0152-17.pdf>.

CDFIs; and government officials with expertise in banking, investment, affordable housing and public finance. The Task Force met eight times over the course of about a year to investigate the concept of a public bank. Using a consensus-based process, they created and finalized a set of guiding principles to inform the work of the Task Force and enumerated and prioritized the goals they wanted to see a municipal bank achieve. After laying this framework, the Task Force and TTX staff researched and discussed various bank and governance structures, lines of business, and options for bank capitalization and deposits.

There are several excellent pieces written that describe the benefits of municipal banking as well as the legal challenges around public banking in California. Rather than re-state that body of work, this report aims to provide the Board of Supervisors, the Mayor and the public with a clear analysis of the financial costs and benefits of a municipal bank given the priorities identified by the Task Force. The Task Force found that a municipal bank is feasible so long as the City commits or secures funding for the effort, and state laws are changed. The Task Force generally identified the desire to disengage from Wall Street and large commercial banks and the desire to reinvest in the community as primary goals, though the Task Force did not achieve consensus over which goal should predominate. The report includes a divestment model, a reinvestment model, and a combination of the two to reflect this lack of consensus.

Regardless of the exact model, the financial and time commitments required to create a municipal bank are quite significant. This demand for City resources raises a series of policy questions regarding the fiscal responsibility of creating a municipal bank, the City's prioritization of resources and projects, and interim solutions or alternatives to a municipal bank that could achieve similar aims. This report seeks to offer concrete analysis related to developing a municipal bank as well as potential alternatives to a municipal bank to

inform and bolster that dialogue and help the Mayor and Board of Supervisors decide whether to move forward with a municipal bank.

The report is split into six sections that build on one another, and in many ways mirror the process that the Task Force went through. The sections proceed as follows:

- About the Task Force – Introduces Task Force members and describes the Task Force process
- Bank Basics – Briefly details how banks operate
- Municipal Bank Primer – Defines municipal banking and what municipal banks can accomplish
- Municipal Bank Models – Offers detailed financial models for three municipal banks
- What Are the Policy & Operational Considerations Around Forming a Municipal Bank – Outlines large policy questions that remain about forming and operating a municipal bank
- Conclusion: A Phased Approach and Next Steps – Concludes with details about a phased path and next steps the City could take should it choose to move forward with a municipal bank

Cost Analysis Perspective

The major goal of this report is to advance the conversation around municipal banking by providing a rigorous quantitative analysis regarding the costs, timing and product mix to be considered upon determining if a public entity should pursue a municipal bank. The report also provides options for a municipal bank or interim steps that may also address the two rationales for a municipal bank – divesting from Wall Street banks and community reinvestment.

All municipal bank models require significant investment over many years that range from 10 to upwards of 50 years. If the funds invested to support the municipal bank are from the

City's General Fund, there are also opportunity costs to creating the bank, since every dollar put towards start-up costs, capitalization or subsidies may be redirected from expanding existing and creating new services provided by the City.

On the other hand, there could be a cost to inaction, as maintaining the status quo and continuing our banking relationships both have explicit and implicit costs. The private banking industry has been responsible for multiple financial crises that have impacted the City, its finances and its residents and their financial health. Aside from the ideological benefits of divestment, there are potential long-term financial gains. A municipal bank is not a quick win but could pay dividends long into the future. Bank of North Dakota serves an example: one hundred years into its existence, it has a track record of excellence. It returns money to the State, promotes the local banking industry and has helped citizens weather various natural disasters and economic crises over the years. The cost-benefit analysis of a municipal bank, then, changes depending on the timescale used. While in the short-term a bank is expensive, in the long-term a bank could make a profit and prove to be a solid investment, assuming business and financial risks are identified and analyzed.

About the Task Force

Members of the Task Force were selected through a competitive application process and include experts from inside and outside government, representing a variety of experiences and opinions. The Task Force consists of advocates working to improve access to banking services and capital for low-income, communities of color; finance

professionals with years of experience in traditional consumer banks, credit unions and CDFIs; and government officials with expertise in banking, investment, affordable housing and public finance. Together, this group has the knowledge and background to plan and evaluate opportunities for the City to use its banking and investment functions to support the local economy.

Task Force staff and members met with many stakeholders, including staff and consultants working on public banking in other jurisdictions, public banking advocates, staff of banks, credit unions and CDFIs, experts in affordable housing, consumer, and small business lending and municipal infrastructure, and banking experts. The people who generously shared their time, energy and expertise – starting with our Task Force members – are all listed below:

Task Force members

John Avalos (National Union of Healthcare Workers), **Ada Chan** (Association of Bay Area Governments), **James Clark** (former U.S. Department of the Treasury), **Marc Franson** (Chapman and Cutler LLC), **Paulina Gonzalez-Brito** (California Reinvestment Coalition), **Kate Hartley** (Mayor's Office of Housing and Community Development), **Sushil Jacob** (Lawyers' Committee for Civil Rights of the San Francisco Bay Area), **Jim Lazarus** (former San Francisco Chamber of Commerce), **Lauren Leimbach** (Community Financial Resources), **Ben Mangan** (Center for Social Sector Leadership at Berkeley Haas), **Ky-Nam Miller** (The Greenlining Institute), **Tim Schaefer** (California Treasurer Fiona Ma), **Nadia Sesay** (Office of Community Investment and Infrastructure), **Tajel Shah** (Office of Treasurer & Tax Collector), **Kat Taylor** (Beneficial State Bank), **Steve Zuckerman** (Self-Help Federal Credit Union)

Staff and consultants working on public banking in other jurisdictions)

Dean Alonistiotis (Chicago, Illinois), **Treasurer John Bartholmew** (Humboldt County,

California), **Todd Bouey** (Los Angeles, California), **David Buchholtz** (Santa Fe, New Mexico), **Michael Burdick** (California), **Bill Dowell** (California), **Bob Eichem** (Boulder, Colorado), **Representative Josh Elliott** (Connecticut), **Dawn Hort** (Oakland, California), **Karen Helms** (Merced County, California), **Chris Herrera** (Los Angeles, California), **Cathy Jackson-Gent** (Global Investment Company - Oakland, California), **Treasurer Hank Levy** (Alameda County, California), **Bill Longbrake** (Washington), **Tim Lueders-Dumont** (Vermont), **Pauline Marx** (Alameda County, California), **Catherine Mele** (Washington State), **Sara Myers** (Vermont), **Shawn Myers** (Washington State), **Eileen Newhall** (California), **Jesse Rawlins** (Seattle, Washington), **Jim Tingey** (Financial Services Solutions – California), **Andrew Westall** (Los Angeles, California), **Treasurer Tina Vernon** (Nevada County), **John Wickham** (Los Angeles, California)

Public Banking Advocates

Marc Armstrong (Commonomics), **Ruth Caplan** (DC Public Banking), **Juli Carter** (California Nurses Association), **Sylvia Chi** (California Public Banking Alliance), **Jessie Fernandez** (PODER), **Jacqueline Fielder** (San Francisco Public Bank Coalition), **Rick Girling** (San Francisco Public Bank Coalition), **Susan Harman** (Friends of Public Bank Oakland), **Mike Krauss** (Public Banking Institute), **Nichoe Lichen** (Banking on New Mexico), **Richard Mazess**, **Walt McRee** (Public Banking Institute), **Dennis Ortblad** (Seattle Public Bank Coalition), **Steve Seuser** (DC Public Banking), **Kurtis Wu** (San Francisco Public Bank Coalition)

Staff of banks, credit unions, and CDFIs

Agneus Cheung (Working Solutions), **Karla De Leon** (Main Street Launch), **Jennifer Finger** (Beneficial State Bank), **Ezra Garrett** (Opportun), **Mark Goldfogel** (Fourth Corner Credit Union), **Pete Hellwig** (New Resource Bank), **Phil Hitz** (OneMain Financial), **Rob Holden** (New Resource Bank), **Craig Johnson** (Beacon Community Bank), **Jen Leybovich** (Main Street Launch), **Stephanie Meade** (New Resource Bank), **Vera Moore** (JP Morgan Chase), **Adria Moss** (Pacific Community Ventures), **Deirdra**

O’Gorman (Fourth Corner Credit Union), **Ed Obuchowski** (Bank of San Francisco), **Nathaniel Owen** (Mission Economic Development Agency), **Sara Ravazi** (Working Solutions), **Wendy Ross** (Bank of San Francisco), **Janel Schmitz** (Bank of North Dakota), **Ray Shams** (San Francisco Federal Credit Union), **Jacob Singer** (Main Street Launch), **Kenneth Till** (CommerceOne Bank), **Victor Vazquez** (Bank of San Francisco)

Experts in affordable housing, small business, and consumer lending and municipal infrastructure

Avital Aboody (LA Más), **Nick Bourke** (Pew Charitable Trust), **Paul Carney** (Tenderloin Neighborhood Development Corporation), **Peter Cohen** (Council of Community Housing Organizations), **Luis Diaz**, (Community Check Cashers), **Alejandro Dobie-Gonzalez** (LA Más), **Rebecca Center Foster** (San Francisco Housing Accelerator Fund), **Ipsheeta Furtado** (Fluid Financial), **John Grogan** (LoansAtWork), **Becca Hutman** (San Francisco Housing Accelerator Fund), **Kiran Jain** (Neighborly), **Katie Lamont** (Tenderloin Neighborhood Development Corporation), **Helen Leung** (LA Más), **Dan Leibsohn** (Community Check Cashers), **Jim Mather** (Housing Trust Silicon Valley), **Fernando Martí** (Council of Community Housing Organizations), **Sam Moss** (Mission Housing Development Corporation), **Abby Murray** (San Francisco Housing Accelerator Fund), **Heather Peters** (San Mateo County), **Jonny Price** (WeFunder), **Eric Tao** (AGI)

Banking experts

Scott Arneson (Fiserv), **Karl Beitel**, **Asya Bradley** (SynapseFI), **David Dubrow** (Arent Fox), **Ashley Elsner** (Green Market Bank), **Gary Findley** (Gary Steven Findley & Associates), **Pat Orchard** (FIS), **Mark Pinsky** (Five/Four Advisors), **Dave Rainer**, **Caitlin Sanford** (Department of Business Oversight), **Phillip Sprinkle** (Jack Henry and Associates), **Mike Stevens** (Conference of State Bank Supervisors), **Walker Todd** (Middle Tennessee State University), **Nancee Trombley** (California Infrastructure Bank)

Other experts

Lauryn Agnew (Bay Area Impact Investing Initiative), **Juliana Choy Sommer** (Priority Architectural Graphics), **Hannah Dithrich** (The GIIN), **Miguel Galarza** (Yerba Buena Engineering & Construction, Inc), **Cara Martinson** (California State Association of Counties), **Amanda Ream** (United Domestic Workers Union/AFSCME)

Throughout this process, the Task Force worked to crystallize the opportunities for a municipal bank, and provide some clarity about costs, legal risks, and opportunities. This process included research, discussion and prioritization of community and financial goals for a bank. With some clear outcomes in mind, the Task Force directed staff to research and report out about bank formation costs, potential bank structures, lines of business and financial models.

Over the course of nine months, the task force held eight public meetings. The content of the meetings was as follows:

- **Meeting 1:** Introductions, outlining guiding principles for a municipal bank, brainstorming exercise to prioritize community outcomes (result: affordable housing, small business lending, infrastructure, un- and underbanked individuals and cannabis)
 - *Follow-up materials:* Municipal Bank Feasibility Task Force Statement of Work, Public Banking Literature Review, Public Bank Regulatory Fact Sheet
- **Meeting 2:** Presentations on bank regulation, Bank of North Dakota, Beneficial State Bank and Self-Help Federal Credit Union
 - *Follow-up materials:* Survey of Task Force members to further prioritize and rank five community goals (result: affordable housing, small business lending, infrastructure, un- and underbanked

individuals and cannabis)

- **Meeting 3:** Discussion of start-up and operational costs for a bank, comparison of balance sheets, income statements and loan portfolios for three banks: Bank of San Francisco, New Resource Bank and Bank of North Dakota
 - *Follow-up materials:* Fact sheet summarizing current City-funded programs in affordable housing, small business lending and infrastructure
- **Meeting 4:** Presentation and discussion of options for funding for capitalization and deposits, as well as potential lines of business for the bank
- **Meeting 5:** Detailed description of and discussion about potential lines of business for the bank as well as operational parameters and governance structure
 - *Follow-up materials:* Draft Executive Summary
- **Meeting 6:** Review Executive Summary and discuss four municipal bank models
- **Meeting 7:** Review three new municipal bank models
 - *Follow-up materials:* Draft Municipal Bank Feasibility Task Force Report
- **Meeting 8:** Review final report
 - *Follow-up materials:* Final Municipal Bank Feasibility Task Force Report

Bank Basics

Before jumping into what a San Francisco municipal bank could look like and what it could accomplish, it is crucial to understand the basics of banking. The crucial dividing line between a bank and a non-bank entity is the ability to accept deposits from outside entities.³ By accepting deposits, banks create a financial

³ California Financial Code §§ 1004-1005.

multiplier effect in the community, lending out deposits to profitable projects and growing the local economy. Banks generate a profit by making loans and charging customers fees. Banks take in deposits and pay interest on some accounts and then lend those deposits out to consumers and receive interest on those loans – the difference between interest paid out and interest received is the “spread” and is typically the source of most bank revenue, though banks also charge fees for services. Banks’ assets are loans, which generate income, and customer deposits are liabilities. As with all businesses, a bank’s assets must cover its liabilities – the difference between a bank’s assets and its liabilities is called the bank capital, which is the bank’s net worth and also “a measure of a bank’s potential to absorb losses.”⁴ A bank with limited capital is higher-risk for depositors, because a small drop in asset values can lead to distress and failure. Historically, banks held eight percent of assets in capital, though capital requirements have increased since the recession with banks holding an average of 12 and even up to 15 percent of their assets in capital.⁵ New banks may be required to hold even more bank capital, as banks use their capital to survive initial years of losses.⁶ Bank capital serves as an investment for whoever owns that capital, and banks can choose to use any profit to pay dividends to shareholders or retain the profits to increase bank capital.

Municipal Bank Primer

The Public Banking Institute, an advocacy organization, defines a public bank as a “chartered depository bank in which public funds are deposited. It is owned by a government unit — a state, county, city, or tribe — and mandated to serve a public mission that reflects the values and needs of the public that it represents. In existing and proposed US Public Bank models, skilled bankers, not the government, make bank decisions and provide accountability and transparency to the public for how public funds are used.”⁷ Los Angeles’ Chief Legislative Analyst’s Office performed a literature review and were unable to find “a consistent definition of such a financial institution beyond the core concept of public ownership,” though it noted that many definitions incorporated adherence to ideals, like racial, economic and environmental justice.⁸ In general, though, a public bank is a bank—an entity that is licensed to accept deposits and make loans—that is owned by and affiliated with a locality, state or nation. A public bank that is owned by a municipality is called a municipal bank (for the purpose of this report the terms

4 Alden, W. (July 10, 2013). What is Bank Capital, Anyway? New York Times. Retrieved from: <https://dealbook.nytimes.com/2013/07/10/what-is-bank-capital-anyway/>. Similarly, the FDIC explains that bank capital “absorbs losses, promotes public confidence, helps restrict excessive asset growth, and provides protection to depositors and the deposit insurance funds.” Federal Deposit Insurance Corporation (April 2015). Capital. Retrieved from: <https://www.fdic.gov/regulations/safety/manual/section2-1.pdf>.

5 Federal Reserve Bank of St. Louis (September 2018). Bank Capital to Total Assets for United States. Retrieved from: <https://fred.stlouisfed.org/series/DDSI03USA156NWDB>; Trefis Team (March 10, 2017), How the Largest U.S. Banks Have Strengthened Their Core Capital Ratios Since 2012, Forbes. Retrieved from: <https://www.forbes.com/sites/greatspeculations/2017/03/10/how-the-largest-u-s-banks-have-strengthened-their-core-capital-ratios-since-2012/#11fd80af445a>.

6 While banks are starting up, bank capital can fund operating costs, make loans (if the bank does not have sufficient deposits) and serve as reserve capital for those loans. The capital requirements for a new bank will often take all these purposes into account. While an established bank must hold anywhere from 8 to 15 percent of assets as capital, a new bank may be required to hold that much in capital plus sufficient funding to sustain the bank until it is able to make a profit.

7 Public Banking Institute. Introduction to Public Banking. Retrieved from: http://www.publicbankinginstitute.org/intro_to_public_banking.

8 Chief Legislative Analyst (2018). Public Banking Framework and Existing Housing and Economic Development Funding Programs. Retrieved from: http://clkrep.lacity.org/onlinedocs/2017/17-0831_rpt_CLA_02-26-2018.pdf.

public bank and municipal bank will be used interchangeably). Like regular banks, public banks need a charter, capital, deposits, and a governance structure and a leadership team. One of the major distinctions between a public bank and private bank is that a public bank could meet community goals rather than solely serve a profit motive. To succeed, a municipal bank must maintain solvency and liquidity and achieve sustainability or make a profit (if growth is the goal), while also adhering to its mission and principles. In this sense, a municipal bank is trying to achieve a double bottom line: meet community goals while still making a profit that can be reinvested to serve the bank's mission.

There are currently two public banks in the United States, the Bank of North Dakota ("BND") and the Territorial Bank of American Samoa. BND was founded in 1919 on a wave of economic populism, capitalized with a \$2 million bond offering and charged with "promoting agriculture, commerce and industry" in North Dakota.⁹ Under North Dakota state law, all state funds must be deposited into BND, which does not have deposit insurance but is instead insured by the "full faith and credit" of the State of North Dakota.¹⁰ BND primarily partners with local banks and credit unions to facilitate agricultural, commercial, real estate and student loans. The other public bank, the Territorial Bank of American Samoa, was founded in 2016 after the last commercial bank left the territory. It recently gained access to the Federal Reserve's payment system in 2018.¹¹ Aside from these two public banks, American Indian tribes also own

and operate 19 banks across the U.S.¹²

When considering the creation of a municipal bank it is crucial to determine community goals to guide the lending and banking activities of a municipal bank. The Board of Supervisors Resolution authorizing the Municipal Bank Feasibility Task Force states that the "Board of Supervisors believes that the medium- long-term interests of the city are aligned with the sustainable and equitable economic growth of its community" and that the "long-term financial and social well-being of the City is contingent upon the ability to provide equitable and transparent opportunity for all of its residents."¹³ When talking about public banking, almost everyone has a different vision of exactly what a municipal bank should do. A major responsibility of the Task Force (and a struggle) was to hone in on community goals. During public hearings and Task Force meetings a variety of ideas came up, including affordable housing, small business lending, divesting from Wall Street, supporting local banks and credit unions, meeting the needs of un- and underbanked individuals, infrastructure, student loans, renewable energy, and cannabis banking.

Over time, two important goals emerged as the most pressing:

1. "Divestment" — Reducing the City's reliance on Wall Street and increasing the City's autonomy over how its deposits are deployed to ensure money isn't used to support harmful industries.¹⁴

9 Swayze, David S. and Christine Schiltz (Spring 2013), State-Owned Banks: A Relic of the Past or the Wave of the Future?, Delaware Banker. Retrieved from: <https://www.pgslegal.com/wp-content/uploads/2017/07/Spring-2013-Delaware-Banker-Article.pdf>.

10 Id.

11 Blackwell, R. (April 30, 2018). American Samoa Finally Gets a Public Bank. And U.S. States Are Watching. American Banker. Retrieved from: <https://www.americanbanker.com/news/american-samoa-finally-gets-a-public-bank-and-us-states-are-watching>.

12 HR&A Advisors Inc. (October 2018). Public Bank Feasibility Study for the City of Seattle. Retrieved from: <http://council.seattle.gov/wp-content/uploads/2018/10/HR-A-Advisors-Public-Bank-Feasibility-Study.pdf>.

13 City and County of San Francisco Board of Supervisors, Resolution 152-17. Retrieved from: <http://sfbos.org/sites/default/files/r0152-17.pdf>.

14 For example, a May 2017 San Francisco Budget & Legislative Analyst report found that of thirteen of the largest banks, all financed at least one of the following disfavored industries: firearms, tobacco, nuclear power, Dakota Access pipeline or private prisons. Budget & Legislative Analyst's Office (May 2017). Memorandum re: Large Bank Social Responsibility Screening. Retrieved from: https://sfbos.org/sites/default/files/BLA_Large_Bank_Screening_051917.pdf.

2. “Reinvestment” — Offering lower-cost financing for City priorities like affordable housing development and supporting small businesses.

Staff met with subject matter experts to identify lines of business that could support these goals. Lines of business were selected primarily because they filled a financing or service gap that currently exists where a municipal bank’s involvement could meaningfully impact the market. The specific lines of business, as well as current status quo, will be explored more fully in the next section which details the municipal bank models and are outlined in more detail in Appendix B.

Municipal Bank Models

The purpose of the models is to elucidate the potential of a municipal bank and provide a financial framework for consideration and debate. These models are estimates based on extensive research and will only be improved over time with more specificity about the overall size of a bank, lines of business, and sources of funds. For those interested in more information about the modeling, the report has a technical appendix (Appendix D), which outlines the data and assumptions behind the models, providing detailed explanations of the banks’ start-up costs, lines of business, and growth rates.

The banks modeled in this section reflect the priorities of the task force – with one bank primarily focused on reinvestment (Model One), one focused on divestment (Model Two), and a third bank that combines both aims (Model

Three). The section below details the main goal of the bank model, the current status quo, operational costs and benefits (in the short- and long-term) and risks. The financial models assume that banks begin with no assets and build their balance sheet up to \$1 billion over 10 years and then increase in size from there.¹⁵ The models project bank operations out to 60 years to show the long-term costs and benefits of creating a bank, recognizing that a bank may require significant investment and subsidy in the short-term, but in the long-term it can pay dividends. Because expenses are greater than revenues when the banks are small, all models will need some amount of operational subsidy, which is funding to keep the bank afloat until it grows large enough to achieve financial sustainability.¹⁶ The length of time it will take a bank to achieve financial sustainability depends on a number of factors, including its expenses, its revenue and lines of business, its growth rate, and economic conditions. Adjusting any one of these multiple levers can shorten or lengthen the time it takes for the bank model to breakeven for the year for the first time.

In contrast, another way to envision a bank model is to present each bank at the size it must operate at to achieve financial sustainability without projecting how long it will take the bank to achieve that scale. This presentation eliminates the uncertainty of long-term forecasting as well as the assumptions about growth. Because the bank begins at a size large enough for sustainability, there are no long-term timelines to profitability or operational subsidies – the assumption is that the bank can achieve profitability shortly after opening (with some ramp-up period to establish its loan portfolio). The bank may need significant capitalization and deposits upfront, which may make it more challenging to open a de novo bank at the size necessary to achieve financial sustainability for some bank models presented below.

¹⁵ This growth rate is comparable to Beneficial State Bank which took about 10 years and multiple acquisitions to hit \$10 billion.

¹⁶ In general, the larger a bank is, the more money it can make. This profitability stems both from the increase in the size of the loan portfolio (which drives revenue) as well as some economies of scale on the expenses side.

Model One: Reinvest

Goals: The first municipal bank model is focused on lending and reinvestment in areas that are underserved by the traditional banking industry. After significant deliberation and prioritization, the Task Force chose to focus on affordable housing and small business lending as top community goals for the reinvestment model. A reinvestment-focused lender can promote outcomes and community goals identified by the Task Force, Board of Supervisors or bank leadership and management. Because it is not constrained by typical shareholder maximization requirements, the bank has slightly more flexibility to enter markets and offer products not typically served by traditional commercial banks. It can increase lending in targeted sectors of the economy and achieve community goals both by lending directly to consumers and by partnering with local community banks, credit unions and CDFIs.

Current State: The City already expends significant money and energy supporting affordable housing and small businesses.

Affordable Housing: The City utilizes numerous funding sources to support affordable housing preservation, rehabilitation and development including:

- Low-income housing tax credits
- Proposition A/C seismic safety loans (\$261 million in total for preserving rent-controlled units)
- Proposition A (\$310 million for rehabilitation and redevelopment of public housing)

- Proposition C Housing Trust Fund (\$20-\$50 million per year for development)
- Inclusionary Zoning and Impact Fees (market rate developers build affordable units or contribute a fee).

In total, Mayor's Office of Housing and Community Development (MOHCD) and the City spends and invests \$400 million per year on affordable housing on subsidies to develop and preserve affordable housing units and on down payment assistance programs which help individual homeowners purchase their first homes.¹⁷ Despite this funding and numerous homeownership and development programs, the City and developers struggle to build sufficient housing fast enough to meet the enormous need. The lines of business presented below all seek to offer developers and homeowners cheaper and faster financing to support the City's goals of developing and preserving all forms of affordable housing.

Small Business Lending: Small businesses are the engine of job creation in our country, our state and our City. In San Francisco, 80 percent of businesses employ ten people or fewer (including sole proprietors), and the City has 33,866 registered businesses that have between two and ten employees.¹⁸ Small businesses have significant need for capital but have difficulties accessing capital because traditional banks shy away from this lending, which is high-touch and high-risk.¹⁹ Despite the challenges, there is a robust ecosystem of small business support in San Francisco, including the U.S. Small Business Administration (SBA), CDFIs, non-profits and City programs all aimed at nurturing

¹⁷ The San Francisco Office of the Mayor. (August 2018). Mayor London Breed Signs Budget Targeting Homelessness, Housing, Street Cleanliness, and Public Safety [Press Release]. Retrieved from: <https://sfmayor.org/article/mayor-london-breed-signs-budget-targeting-homelessness-housing-street-cleanliness-and-public>. For more information on specific City programs aimed at affordable housing, see Appendix E discussing current City work on affordable housing.

¹⁸ Internal analysis from the Office of Treasurer & Tax Collector.

¹⁹ A 2016 Federal Reserve survey found that 44 percent of small businesses stated that their top challenge was "credit availability or securing funds for expansion." Federal Reserve Bank (April 2017). Small Business Credit Survey. Retrieved from: <https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-EmployerFirms-2016.pdf>.

and growing our small business community. For example, the SBA guarantees a portion (typically 75-85 percent) of small business loans originated by banks. The average size of an SBA loan is approximately \$350,000, though they can be up to \$5 million in size.²⁰ Additionally in San Francisco, numerous CDFIs²¹ offer loans between \$5,000 and \$250,000 at reasonable rates as well as technical assistance and business coaching for businesses that may not be able to access standard commercial bank or SBA loans. Many of these CDFIs are not able to cover their costs with revenue and receive philanthropic funding, leading to difficulties scaling up. Within the City, the Office of Economic and Workforce Development (OEWD) and the Office of Small Business also support small business through direct lending programs, grant programs and grants to non-profit lenders to support their work. Some example of direct lending and grant programs are highlighted below:

- **Small Business Revolving Loan Fund** – It offers microloans up to \$50,000. It is administered by Main Street Launch, a local CDFI. The City covers the administrative costs, and Main Street Launch provides the capital. Since 2009, it has issued 161 loans totaling over \$4.57 million. In 2017, it issued 20 loans totaling \$816,000. Its loans range in interest from 3.5% to approximately 7.75%.
- **Emerging Business Loan Fund (EBLF)** – It offers up to \$250,000 in loans to small businesses. It is administered by Main Street Launch, a local CDFI. The City covers the administrative costs, and Main Street Launch provides the capital. Since 2013, it has closed over 120 loans totaling \$16.8 million. Its loans are offered at approximately 7.75%.
- **SF Shines Façade and Tenant Improvement Program** – Since 2009, it has provided technical assistance, business strengthening, and 117 grants (from \$10,00

to \$150,000) totaling \$4.3 million for improving commercial storefront facades and business interiors. The current program budget is \$1 million.

- **Americans with Disabilities Act (ADA) CASp Grant Program** – Since 2013, it has provided technical assistance and 647 grants (from \$1,000 to \$3,000) totaling over \$1 million for ADA compliance assessments.

Despite all this effort, small business advocates and CDFI staff believe that gaps remain in small business lending. The following lines of business aim to fill those gaps and also support the excellent work being done by CDFIs.

Activities: Model One is a municipal bank that secures funding through debt and performs affordable housing and small business lending. It will not perform the City's cash management and commercial banking. This model would not require a bank charter or deposit insurance, because the bank would not accept deposits or serve as the City's banker, but it would need similar capitalization to a traditional bank. Model One will perform real estate lending and small business lending at below-market rates to decrease the cost of funding affordable housing and assist small business development. The section offers a short description of the lines of business, and more details about the lines of business are available in Appendix B.

Real Estate Lending: The real estate lending lines of business will include mezzanine debt (which sits between equity and more senior debt and is the highest-risk form of debt) for workforce housing acquisition and development, mortgages for the small sites acquisition program and loans to finance accessory-dwelling unit construction. 85 percent of the bank portfolio (\$850 million at \$1 billion

20 Wang, A. (February 5, 2019). SBA Loans: What you Need to Know. Nerd Wallet. Retrieved from: <https://www.nerdwallet.com/blog/small-business/small-business-loans-sba-loans/>

21 These CDFIs include Main Street Launch, The Opportunity Fund, Mission Economic Development Agency's Fondo Adelante, Pacific Community Ventures and Working Solutions.

in loans) are modeled as real estate loans. The average size of a real estate loan is \$5 million for a total of 170 loans in the portfolio (at \$1 billion in loans). The interest rate is 5 percent, loss rate is 1-2 percent and average term is 3 to 5 years, though individual loan may be significantly longer, up to 30 years.

Wholesale Small Business Lending: The municipal bank would lend large sums of money to CDFIs at low rates, and these CDFIs would use this money to issue small business loans at lower than for-profit market rates. This lending represents 12.5 percent of the bank’s portfolio (\$125 million at \$1 billion in loans). The average size of a wholesale small business loan would be \$2 million, and the portfolio would have approximately 60 in total at \$1 billion in loans. The interest rate is 2.5 percent, which is slightly below the rate CDFIs are charged by traditional private banks (typically 3 to 4 percent). The loss rate is modeled at 0.5-1 percent, because CDFIs have significant reserves and strong underwriting for their loans. The average loan term is 5 years.

Direct Small Business Lending: The municipal bank would offer small business loans to businesses directly. The bank is modeled with 2.5 percent of its portfolio (\$25 million at \$1 billion) as direct small business lending for a total of approximately 700 loans at any given time. The average size of these loans is modeled at \$35,000. The interest rate is modeled at 15 percent; the loss rate is modeled at 15-30 percent, and the average loan term is 3 to 5 years.

Though not included in Model One, there were two other lines of business that were of interest to members of the public and the Task Force. The details on these lines of business are provided below but not included in the model.

Direct Student Lending (Not Modeled): For direct student lending, the municipal bank could offer student loans to residents of San Francisco and those studying at colleges and universities in San Francisco. The average loan size would be \$10,000. Interest rates would be modeled at 4.5 percent based on BND’s published rates

Table 8: Model One Lines of Business at \$1 Billion in Loans

	Loan Assets at \$1B (\$MM)	Percent of Loans at \$1B	Number of Loans at \$1B	Average Size of Loan	Average Interest Rate	Estimated Loss Rate (Low-High)	Average Loan Term
Real Estate Lending (ADU, mezzanine debt, small sites)	850	85%	170	\$5,000,000	5%	1-2%	3-5 years
Wholesale Small Business Lending	125	12.5%	60	\$2,000,000	2.5%	0.5-1%	5 years
Direct Small Business Lending	25	2.5%	700	\$35,000	15%	15-30%	3-5 years

as of the end of July 2018 with a loss rate of 2 percent based on BND and other private student loan companies' loss rates. The student loan line of business would bring in modest profits.

Green Energy Loans (Not Modeled): For green energy loans, the municipal bank could offer loans for renewable energy projects for small businesses and homeowners. The average loan size would be \$50,000, and interest rates would be modeled at 4-5 percent based other banks' rates. Loss rate would be an estimated 1-2 percent. This line of business would result in a similar profile and profit to the real estate and affordable housing loans.

Operational Components:

To achieve financial sustainability, Model One must be \$1.1 billion in size. The model projects it will take around 10 years to break even operationally for the year (the low-estimate projects a surplus after 4 years, and the high-

estimate never achieves a surplus). In the first 10 years, the bank will need \$13 million in subsidies to maintain operations (ranging from a low of \$4 million and a high of a continuous subsidy throughout operations that reaches \$42 million per year in the model). The start-up costs will be lower than in Model Two and Three, only \$5 to 7.5 million, because Model One will not need the infrastructure to perform the City's commercial banking, nor will it need the compliance and regulatory components required for a bank. Though it is not a legal requirement, Model One should operate with 15 percent of its assets held as capital. At \$1.1 billion this figure is \$165 million, and it will increase as Model One gets larger. Model One will also need to secure funding through debt to use as a lending base that is equivalent to the size of the bank assets less bank capital, so, for example at \$1.1 billion in assets and \$1 billion in loans, Model One will need to secure \$935 million in debt to perform its lending.

Table 9: Estimated Range of Costs Associated with Model One

Cost Type	Average Cost	Low and High Cost Estimates	Description	Timeframe
Size at annual breakeven	\$1.1 billion	\$330 million – never	Estimated asset size for bank to breakeven	–
Start-up costs	\$6.25 million	\$5 million – \$7.5 million	Cost for staffing, real estate, technology infrastructure	Approximately 2 years before operations
Balance sheet capital at annual breakeven	\$165 million	\$50 million – never	Capital equivalent to 15% of assets at breakeven	Year 1+ until operation ceases

Table 10: Financial Projections for Model One for the First Ten Years (Low & High Estimates)

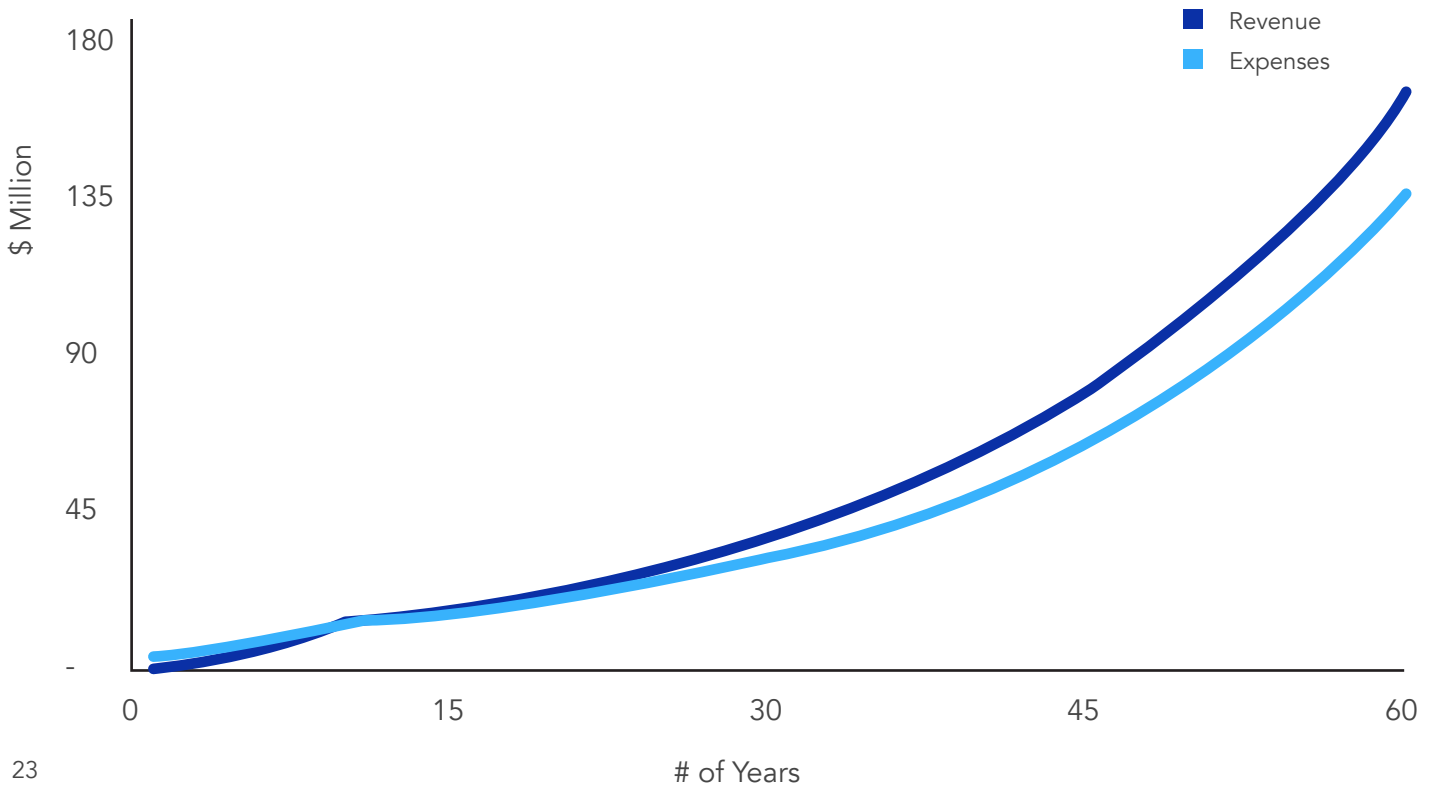
	Value of Net Outstanding Loans Per Year (\$ million)	Total Assets Per Year (\$ million)	Net Surplus (Deficit) Per Year - Low Range (\$ million)	Net Surplus (Deficit) Per Year - High Range (\$ million)
Start-Up Years	-	-	(5)	(8)
Year 1	50	55	(2)	(3)
Year 2	75	83	(1)	(3)
Year 3	125	138	(1)	(3)
Year 4	200	220	(0)	(4)
Year 5	300	330	1	(4)
Year 6	400	440	2	(4)
Year 7	500	550	2	(5)
Year 8	650	715	4	(5)
Year 9	800	880	5	(6)
Year 10	1,000	1,100	7	(6)
Total			12	(51)

Capital for Balance Sheet

(165)

(165)

Figure 1: Projected Expenses & Revenue Over Time for Model One (Average Estimate)



Outcomes: The municipal bank will allow the City to reinvest in the community and serve people, businesses and projects that are currently underserved or unserved by the traditional banking industry. With \$1 billion in loans, the municipal bank will be able to bring \$1 billion in investment to bear, and the model projects the bank can make approximately 170 affordable housing loans, 60 wholesale small business loans (which will result in numerous small business loans), and 700 direct small business loans. The City currently invests \$400 million per year in affordable housing. At \$1 billion in loans, the municipal bank would add another \$850 million in lending that would revolve on average in 3 to 5 years, adding another \$200 million or so to the \$400 million in investment for affordable housing per year. This added affordable housing will have further multiplier effects with one analysis finding that building 100 rental apartments results in \$11.7 million in local income, \$2.2 million in taxes and revenue and 161 local jobs.²² For small business lending, the bank would add \$125 million in wholesale loans and \$25 million for approximately 700 in direct loans compared to the about 50 loans for a total of \$50 million currently issued by the City's Small Business Revolving Loan Fund and Emerging Business Loan Fund.

Risks: The primary risk associated with Model One is the unconventional lending portfolio it will pursue, and the concern that the lines of business as modeled above are unrealistic or unattainable. A lender that performs lending spurned by other banks or that performs lending at below-market rates is necessarily taking larger risks and may face higher defaults than expected or may need to tighten its underwriting standards and perform less lending than anticipated. The model itself includes significant uncertainty about how Model One will perform. With low-end estimates of start-up costs and loan losses, the bank achieves

sustainability within 4 years. Under the high-end estimate, which doubles projected loan losses, Model One never breaks even and needs a significant subsidy per year (\$6 million per year at \$1 billion in size to upwards of \$42 million per year at \$12 billion in size) in perpetuity to stay afloat.

The difference in the model reflects how loan loss rates, and in particular a higher loan loss rate than expected, can impact bank operations and slow or prevent a path to breaking even. Concerns about loss rates become especially salient as the bank scales and must source a significant number of loans and deals for its portfolio. Bank size was determined based on Task Force feedback, economies of scale and achieving sustainability rather than size of market demand. It's not clear whether performing \$200 million per year in affordable housing investment of the type contemplated in the model in San Francisco is realistic (the scale the bank would perform at \$1 billion in loans).²³ If market demand and the execution capability of the team assembled to run the bank cannot meet the scope of the municipal bank as modeled, the municipal bank would have to adjust its strategy. The bank could possibly change its product lines or seek opportunities outside of San Francisco. Without adjusting its strategy, it may not be able to achieve the scale modeled or may operate at a greater loss than the high-end estimate.

Loan loss rates are particularly high for the small business lending portfolio, and in the high-cost estimate, small business losses prevent the bank from ever achieving sustainability. These high loss rates led Task Force members to suggest that the bank would need to increase its underwriting standards for this work or pursue an alternative method of encouraging small business lending. Rather than lend directly to small businesses, Task Force members suggested that the municipal bank could

²² California Legislature, "Senate Bill 3," Section 2(h), https://leginfo.ca.gov/faces/billCompareClient.xhtml?bill_id=201720180SB3.

²³ By comparison, the SF Housing Accelerator Fund, a non-profit affordable housing investment fund, has invested over \$60 million in affordable housing investment in nine deals in a little over its first year of operations.

guarantee small business loans made by other banks and credit unions, similar to the SBA guarantee program or the California CalCAP Collateral Support (CalCAP CS) program. A guaranty arrangement allows the municipal bank and City to encourage lending that wouldn't otherwise happen without requiring the municipal bank to put its own capital into the loan or perform the administrative tasks associated with loan underwriting, originating and servicing.

Lastly, though the bank does achieve a surplus under low-cost and average-cost estimates, it never will become a significant source of revenue. Though under some estimates Model One will achieve a surplus, become self-sustaining and therefore continue to reinvest in the community indefinitely, it will never become a large generator of income for the City and will not be able to return dividends to the City like Bank of North Dakota does for North Dakota.

Bottom-Line: The reinvestment bank outlined in Model One would support affordable housing and small business lending in San Francisco. The model projects that it would require an estimated \$5 to \$7.5 million in start-up costs and operational subsidies estimated at \$13 million (with estimates ranging from \$4 million to an ongoing operational subsidy of many millions per year) before it would break even at \$1.1 billion in size after 10 years of operation (with estimates ranging from a breakeven at \$330 million in size at 4 years to never). The bank would also need \$165 million in capital at the annual breakeven point, which would increase over time as the bank grew larger.

Model Two: Divest

Goals: The goal of the "Divest" model is to envision a public bank that can meet the City's cash management and commercial banking

needs, allowing the City to avoid working with large banks with practices the City finds objectionable. By removing its banking services from large commercial banks, the City could gain more autonomy over how its short-term deposits are used. The model removes the \$100 million currently held in Bank of America accounts. This model does not assume any deposits from or impact on the City's Treasurer's Pooled Investment Fund which is a collection of county, school and special district funds which currently holds over \$11 billion. The money in the pool comes from tax revenues, fees, federal and state government, and bond proceeds. All of these funds have already been allocated through the budgetary process and through voter-initiated bond approvals and as part of the capital plan. State law and the City's investment policy sharply limit how the Treasurer can invest the Pool, and in general these investments must be of the highest quality and most secure and short-term in duration. For example, almost 60 percent of the Pool is currently invested in treasuries and federal agencies, and over 50 percent held in securities under 1 year in duration.

Current State: The City currently contracts with two large corporate banks, Bank of America and U.S. Bank, to fulfill our City's banking needs. The fees paid to Bank of America and U.S. Bank for banking services total approximately \$600,000 per year. These costs are deducted from the interest the City earns on its deposits. The interest is accrued on the nightly \$100 million deposited into the bank (these deposits are collateralized for safety) which are used for daily transactions and to pay for banking fees. The City has an annual budget of \$11 billion and requires banking services like that of a large multi-national corporation. Annually, San Francisco generates approximately 8 million payment transactions amounting to approximately \$13 billion. The City has over 200 bank accounts, and the City processes

24 This figure is lower than the one reported in the November 2017 Budget & Legislative Analyst's report because TTX has taken steps to reduce its banking fee by removing armored car services and supplies from the banking contract and closing underutilized accounts.

significant transactions per year, including:

- 1.2 million checks deposited
- 323,000 credit card transactions for a total of \$1.2 billion per year
- 847,000 outgoing payments
- 415 outgoing wires
- 3,200 incoming wires
- Approximately 700,000 ACH credits
- Approximately 500,000 ACH debits

For reference, the City of Seattle Public Bank Feasibility study found that only a national bank with assets greater than \$50 billion possesses the scale and capacity to meet Seattle’s banking needs, and given San Francisco’s larger budget and status as a City and County it has even greater banking needs than Seattle. Only about 40 banks in the country hold \$50 billion in assets or more, and most are large global banks rather than merely regional or national banks.

Activities: Model Two is a municipal bank that accepts deposits, performs the City’s cash management and commercial banking, and participation lending.

City’s Commercial Banking: The municipal bank would serve as the City’s commercial banker, providing disbursements, deposits, cash management, payment processing, and

reporting and technology solutions.²⁵ The municipal bank will hold about \$100 million in deposits that are currently held in Bank of America, and under current state law this money must be collateralized via eligible securities at 105-to-150 percent of its value.²⁶ The bank would charge the City \$600,000 for this work, equivalent to the fees currently paid to Bank of America.

Participation Lending: The municipal bank would partner with banks to perform participation lending, where a bank partners on lending performed by other banks. In this instance, the municipal bank would initially purchase loans originated by other banks. The goal of this lending is to subsidize the cash management operations of the bank (as a reminder: banks primarily make money by lending out their deposits at a higher rate than the interest that they pay on those deposits). If the municipal bank chose to purchase loans from local community banks or credit unions, this participation lending could support the local banking industry by providing additional liquidity, though this is not the primary aim of the lending portfolio. The model estimates that the average size of the loan is about \$5 million with a four percent interest rate, a loss rate of 0.25-0.5 percent and an average term of 17 years.

Table 11: Model Two Lines of Business at \$1 Billion in Loans

Lines of Business	Loan Assets at \$1B (\$MM)	Percent of Portfolio at \$1B	Number of Loans at \$1B	Average Size of Loan	Average Interest Rate	Loss Rates	Average Loan Term
Participation Lending	1,000	100%	200	\$5,000,000	4%	0.25-0.5%	17 years

²⁵ The bank will still utilize financial technology companies for IT systems and an armored courier provider for transporting currency.

²⁶ California Government Code § 53652.

Operational Components:

To achieve financial sustainability, Model Two must be \$3.1 billion in size. The model projects it will take around 31 years to break even operationally for the year (the low-estimate projects a surplus after 25 years, and the high-estimate projects 37 years). In the first 31 years, the model estimates the bank will need \$990 million in subsidies to maintain operations until it can break even and achieve a surplus (with estimates ranging from \$580 million to

\$1.5 billion). The bank will also need to hold capital equivalent to 15 percent of assets – at least \$165 million at \$1.1 billion in assets and increasing from there. The bank will also need a deposit base equivalent to the size of the bank assets less bank capital, so, for example at \$1.1 billion in assets and \$1 billion in loans, the bank will need to secure \$935 million in deposits to perform its lending.

Table 12: Estimated Range of Costs Associated with Model Two

Cost Type	Average Cost	Low and High Cost Estimates	Description	Timeframe
Size at annual breakeven	\$3.1 billion	\$2.3 billion – \$4.1 billion	Estimated asset size for bank to breakeven	–
Start-up costs	\$119 million	\$95 million – \$143 million	Cost for staffing, real estate, technology infrastructure	Approximately 2 years before operations
Balance sheet capital at annual breakeven	\$460 million	\$340 million – \$615 million	Capital equivalent to 15% of assets at breakeven	Year 1+ until operation ceases

Table 13: Financial Projections for Model Two for the First Ten Years (Low & High Estimates)

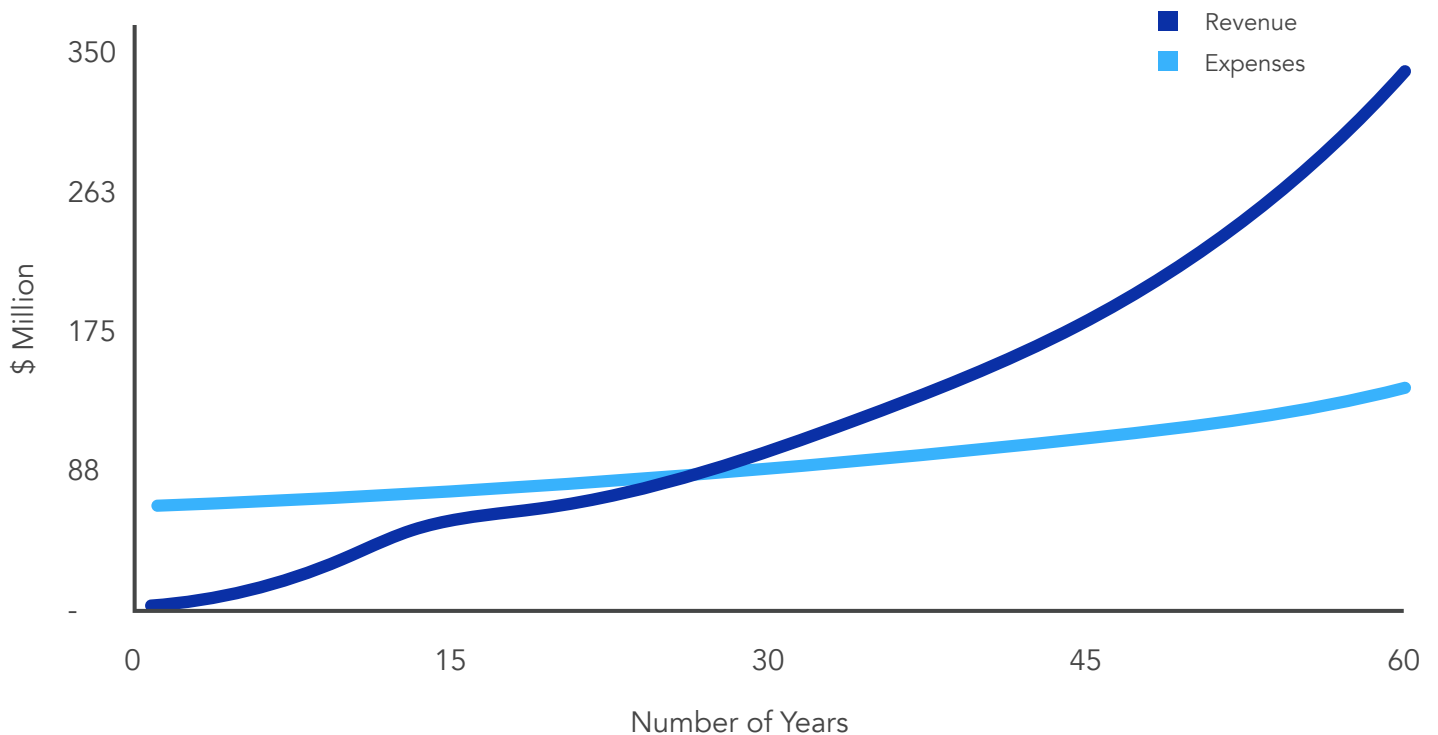
	Value of Net Outstanding Loans Per Year (\$ million)	Total Assets Per Year (\$ million)	Net Surplus (Deficit) Per Year - Low Range (\$ million)	Net Surplus (Deficit) Per Year - High Range (\$ million)
Start-Up Years	-	-	(95)	(143)
Year 1	50	55	(48)	(73)
Year 2	75	83	(48)	(73)
Year 3	125	138	(46)	(72)
Year 4	200	220	(44)	(70)
Year 5	300	330	(42)	(68)
Year 6	400	440	(39)	(66)
Year 7	500	550	(37)	(64)
Year 8	650	715	(33)	(61)
Year 9	800	880	(30)	(58)
Year 10	1,000	1,100	(25)	(54)
Total			(488)	(804)

Capital for Balance Sheet

(165)

(165)

Figure 2: Projected Expenses & Revenue for Model Two Over Time (Average Estimate)



Outcomes: The municipal bank will allow the City to divest from commercial banking partners (though the bank will still utilize financial technology companies for IT systems and an armored courier provider). The municipal bank will also perform significant participation lending – at \$1 billion in loans, it will offer 200 loans at \$5 million each to support its operational costs.

Risks: Though the participation lending performed by the bank in Model Two is quite secure, there are still risks associated with chartering and operating a divestment model bank. First, the bank has significant capitalization, start-up and operational costs and will require years of investment by the City before it achieves a surplus. The City would not only need to raise money for start-up costs and capitalization, but it must continue to subsidize the bank for decades. Regulators may be reluctant to approve a bank that requires subsidies or injections for so many years. Because the lending portfolio is relatively long-term term, it is vulnerable to a maturity mismatch (where deposits are owed at a different time than loans mature) or interest rate rises (where the bank must pay more interest on deposits reducing the value of its lending portfolio). Lastly, a bank that is responsible for performing the City’s cash management has no room for error. It must perform the City’s cash management functions perfectly because any operational issues could impair the City’s daily functioning and result in the City not making payroll or missing a debt payment.

Bottom-Line: A bank that can perform the City’s commercial banking functions and participation lending must be \$3.1 billion in size to achieve financial sustainability, with an average \$460 million in bank capital and \$119 million in start-up costs. The model projects

it could take the bank 31 years of losses (with estimates ranging from 25 to 37) before it breaks even on an annual basis, and during this time it would require operational subsidies of \$990 million (with estimates ranging from \$580 million to \$1.5 billion). At \$3.1 billion in size, the average breakeven point, the bank would buy \$2.8 billion in participation loans to cover its operating costs, which could equate to over 560 participation loans of \$5 million each.

Model Three: Combination

Goals: The goal of the combination model is a public bank that both divests – performing the City’s cash management and commercial banking – and reinvests in the community by performing affordable housing and small business lending.

Model Three represents the widest spectrum of municipal bank activities and reaches the fullest potential of a municipal bank of all three models, because it combines reinvestment and divestment activities. For some members of the Task Force and the public anything that falls short of both divestment and reinvestment does not do justice to the idea of a municipal bank.

Activities: Model Three is a municipal bank that accepts deposits, performs the City’s cash management and commercial banking, and affordable housing and small business lending. The activities of Model Three combine the City’s commercial banking in Model Two with the real estate lending, wholesale small business lending and direct small business lending in Model One. As with Model One and Model Two, Model Three will not perform retail banking for customers.

Table 14: Model Three Lines of Business at \$1 Billion in Loans

	Loan Assets at \$1B (\$MM)	Percent of Loans at \$1B	Number of Loans at \$1B	Average Size of Loan	Average Interest Rate	Estimated Loss Rate (Low-High)	Average Loan Term
Real Estate Lending (ADU, mezzanine debt, small sites)	850	85%	170	\$5,000,000	5%	1-2%	3-5 years
Wholesale Small Business Lending	125	12.5%	60	\$2,000,000	2.5%	0.5-1%	5 years
Direct Small Business Lending	25	2.5%	700	\$35,000	15%	15-30%	3-5 years

Operational Components:

To achieve financial sustainability, Model Three must be \$10.4 billion in size with \$1.6 billion in bank capital. The model projects it will take around 56 years to break even operationally for the year (the low-estimate projects a surplus in 36 years, and the high-estimate never achieves a surplus). During these years of losses, the bank will need an average \$2.2 billion in subsidies to

maintain operations until it can break even (with estimates ranging from \$980 million through a continuous \$78 million per year subsidy). The bank will also need a deposit base equivalent to the size of the bank assets less bank capital, so, for example at \$1.1 billion in assets and \$1 billion in loans, the bank will need to secure \$935 million in deposits to perform its lending.

Table 15: Estimated Range of Costs Associated with Model Three

Cost Type	Average Cost	Low and High Cost Estimates	Description	Timeframe
Size at annual breakeven	\$10.4 billion	\$3.9 billion – never	Estimated asset size for bank to breakeven	–
Start-up costs	\$119 million	\$95 million – \$143 million	Cost for staffing, real estate, technology infrastructure	Approximately 2 years before operations
Balance sheet capital at annual breakeven	\$1.6 billion	\$590 million – never	Capital equivalent to 15% of assets at breakeven	Year 1+ until operation ceases

Table 16: Financial Projections for Model Three for the First Ten Years (Low & High Estimates)

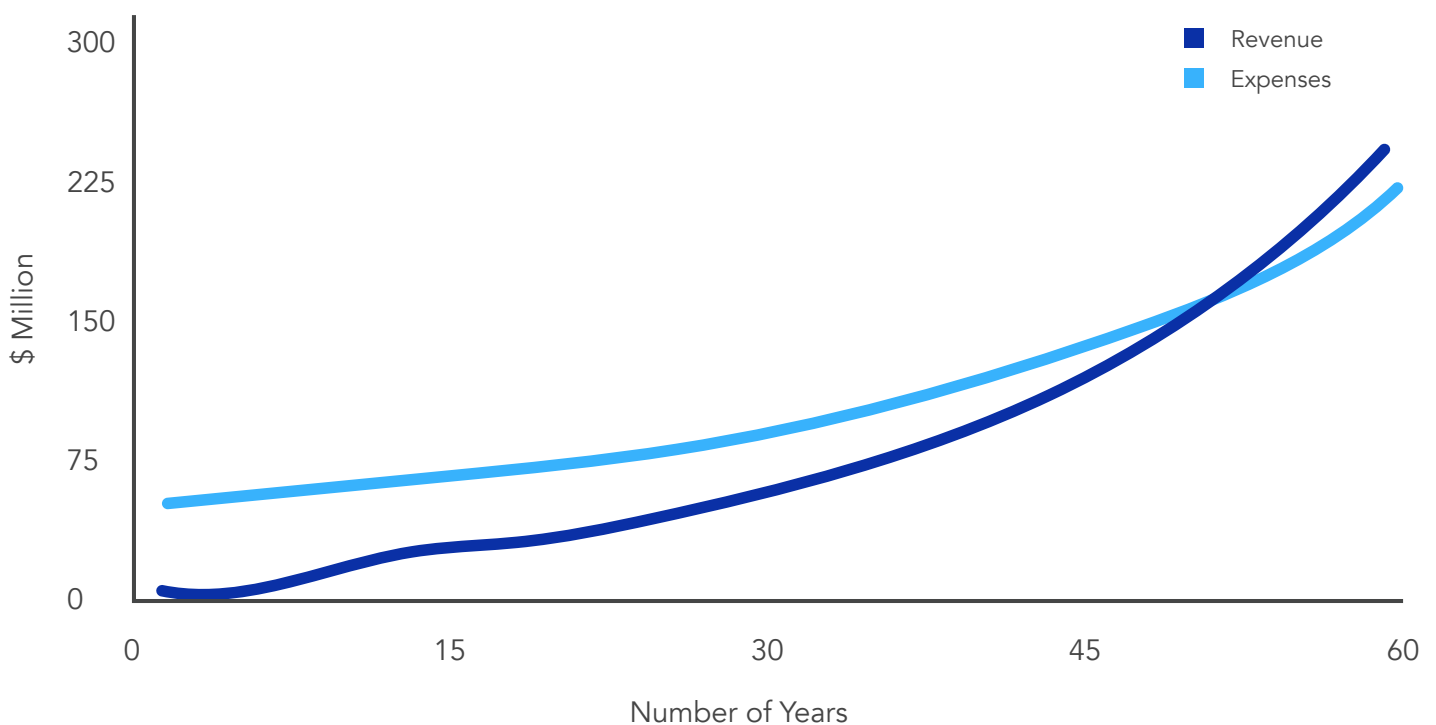
	Value of Net Outstanding Loans Per Year (\$ million)	Total Assets Per Year (\$ million)	Net Surplus (Deficit) Per Year - Low Range (\$ million)	Net Surplus (Deficit) Per Year - High Range (\$ million)
Start-Up Years	-	-	(95)	(143)
Year 1	50	55	(49)	(74)
Year 2	75	83	(48)	(74)
Year 3	125	138	(48)	(74)
Year 4	200	220	(47)	(74)
Year 5	300	330	(45)	(74)
Year 6	400	440	(44)	(74)
Year 7	500	550	(42)	(75)
Year 8	650	715	(40)	(75)
Year 9	800	880	(38)	(75)
Year 10	1,000	1,100	(36)	(75)
Total			(532)	(888)

Capital for Balance Sheet

(165)

(165)

Figure 3: Projected Expenses & Revenue for Model Three Over Time (Average Estimate)



Outcomes: The municipal bank will allow the City to divest from commercial banking partners. The municipal bank will also perform significant lending in the community. As in Model One, at \$1 billion in loans, the municipal bank will make approximately 170 affordable housing loans, 60 wholesale small business loans (which will result in numerous small business loans), and 700 direct small business loans. As the bank scales up, the magnitude of its investment in the community will similarly scale.

Risks: Intuitively, the risks of Model Three include the risks associated with Model One and Model Two; however, these risks compound, because Model Three includes the high costs and strenuous demands associated with performing the City's commercial banking work in addition to the riskier and more labor-intensive lending portfolio. Model Three struggles to achieve sustainability because it combines the high start-up and overhead costs of performing the City's cash management with the reduced profit resulting from a lower-margin but high-impact lending portfolio.

The slowness of Model Three's path to profitability increases the operational, political and regulatory risks. Each year, there is concern that the bank will lose political support and thus its subsidy or that regulators will intervene. Over the course of 56 years, economic conditions may force the bank to change its business model or may stymie its growth. Additionally, the longer the time frame modeled, the less reliable the model results.

Bottom-Line: A bank that can perform the City's commercial banking functions and reinvestment via affordable housing and small business lending must be \$10.4 billion in size to achieve financial sustainability, with an average \$1.6 billion in bank capital and \$119 million in start-up costs. The model projects it could take the bank 56 years of losses (with estimates ranging

from 36 years to never) before it breaks even on an annual basis, and during this time it would require operational subsidies of \$2.2 billion (with estimates ranging from \$980 million to a continuous \$78 million per year).

Assumptions

All financial models rely on a set of assumptions about how a business will operate and the prevailing economic conditions. To model the municipal bank structures outlined above, TTX staff and the Task Force made a number of assumptions about municipal bank operations. The assumptions are listed below with a brief explanation. For more details on the modeling methodologies, refer to Appendix D, the technical appendix.

Assumption #1: The bank will provide one percent return to depositors except in Model One. Models Two and Three project that the bank's cost of funds would be one percent, meaning the City and other depositors would receive a one percent return on their deposits. Bank of North Dakota's cost of funds is 0.6 percent, and most community banks and credit unions tend to have a cost of funds around one percent.²⁷ It is important to note that a one percent return may be less than what the City and other depositors would get from other banks and investments (currently the City receives about 0.8 percent on its Bank of America deposits). However, other mission-driven banks that offer similar returns note that they have no problems securing deposits because institutions are interested in supporting their work. Model One, which lacks a banking charter, will have to pay a higher cost of funds, estimated at two percent, because it must raise debt rather than accept deposits, and debt requires a higher rate of return for investors, because it is perceived as riskier.

²⁷ For example, members of the Federal Home Loan Bank of San Francisco reported a cost of funds of 1.06 percent for November 2018. Federal Home Loan Bank of San Francisco. Cost of Funds Indices. <http://www.fhlbsf.com/resource-center/cofi/>

Assumption #2: Models Two and Three envision a bank that performs the City's cash management. The municipal banks modeled in scenario two and three envision a bank that takes over the City's cash management and commercial banking from Bank of America and U.S. Bank, the City's current banking vendors. The municipal bank would be responsible for treasury management, disbursement and deposits, and credit card processing.

Assumption #3: No models envision a bank that serves as a bond underwriter or custodian of the investment pool. Aside from cash management and commercial banking, the City also utilizes large commercial banks to underwrite bonds, a form of debt to fund long-term projects, and serve as custodian of the investment pool. Bond underwriters help the City sell its bonds to investors, and a municipal bank would need to be a registered broker-dealer and have expertise in capital markets with a sales channel to perform this work. This expertise is separate and apart from traditional community banking. Similarly, the models do not envision the municipal bank serving as the custodian of the Treasurer's Pooled Investment Fund, because it is not possible to lease a platform for custodian work, and the cost to develop the technology and hire staff would outweigh the limited fee income (currently \$200,000 per year).

Assumption #4: The bank will not provide any non-lending retail services. The municipal banks modeled do not offer traditional retail banking services for personal or business clients (such as cash management, debit cards, ACH payments etc.), because it is difficult to perform retail banking well, and retail banking greatly increases infrastructure and staffing costs. Banks typically lose money on free checking accounts, and banking experts noted that providing high-quality retail services would be costly.²⁸ To avoid this loss, the municipal bank will not offer retail services.

Assumption #5: Models include income from interest spread and commercial banking fees. A typical community bank earns about 80 percent of its income from interest and 20 percent from fees (such as overdraft fees, account maintenance fees etc.). The bank models assume that revenue comes from interest income (the spread between the interest charged on loans and the interest paid out on deposits), and the \$600,000 fee that the municipal bank charges to the City for its commercial banking work in Models Two and Three. Aside from that fee, the bank does not include any fee income. The bank likely will charge fees for its services (such as origination fees, servicing fees etc.), but these fees are not included in the model.

Assumption #6: Interest rates for direct loans are modeled below-market: Interest rates for direct loans are intentionally modeled below market rate as the goal of the reinvestment model is to fill gaps in current banking practices and spur investment. Though the models include one interest rate per line of business, this rate is not monolithic (it represents a blended rate and rates may vary based on the project), and interest rates will change over time as the economic conditions and market rates change.

Assumption #7: Loss rates are modeled based on industry comparisons but may be higher given a riskier portfolio: To the maximum extent possible, the bank models utilize loss rates based on industry comparisons. Because some of the municipal bank models envision a riskier lending portfolio, all loss rates are ranges, to reflect that the loss rate may be higher than industry comparisons.

Assumption #8: Source of capital is not defined. The bank models identify an estimated amount of capital that is required to support the bank's operations. The source of the capital is not defined, and the models do not depend on capital coming from any particular source.

²⁸ Claes, B. (December 14, 2011). Banks lose big on free checking. Bankrate.com. Retrieved from: <https://www.bankrate.com/financing/banking/banks-losing-big-on-free-checking/>.

Assumption #9: Source of deposits is not defined. The bank models identify an estimated magnitude of deposits that is required to support the bank's lending portfolio. The source of these deposits is not identified, and the models do not depend on deposits coming from any particular source; however, the bank will not provide retail banking services (except to the City), so the depositors must be comfortable using the bank as a savings account rather than a checking account. The bank may need to pay a slightly higher return to depositors, because it seeks longer-term deposits.

Assumption #10: The bank will keep ten percent of funds liquid. As noted above, banks primarily make money by lending deposits out at a higher interest rate than they pay to depositors. However, banks typically do not lend out all their assets and keep some on-hand as cash or other highly-liquid assets. Similarly, the municipal bank is modeled as lending out 90 percent of assets and holding ten percent of assets in liquid assets.²⁹

²⁹ This liquidity explains the distinction made in the models below between the size of the bank (for example, \$1.1 billion in assets) and the size of the lending portfolio (for example, \$1 billion in loans).

What Are the Policy & Operational Considerations Around Forming a Bank?

The proposed lines of business and municipal bank models presented above are not meant to be the final word on the options available to the City in creating a municipal bank. Instead, they illustrate several directions – bank versus non-bank entity, divestment versus reinvestment – a bank could take and outline the costs, benefits and risks associated with municipal banking. In developing and analyzing these models as well as the steps necessary to create a municipal bank, a number of important policy considerations emerged. This section highlights the major policy questions that remain around creating a municipal bank that can help answer the question of whether a municipal bank is a

good policy idea.

Based on the municipal bank models, the City would need to raise at least \$165 million in capital and find upwards of \$935 million in debt or deposits. A major policy question becomes: where can the City find funding for capitalization and deposits?

Sources of Bank Capital

General Fund Appropriation

The most straightforward way to secure capital is for the Board of Supervisors and the Mayor to allocate funds from the general fund during their standard budget process. Though the City has a budget of \$11 billion, only about \$2.2 billion of that money is discretionary as the rest belongs to enterprise departments or is set aside for specific voter-mandates. That \$2.2 billion must fund all non-enterprise departments and City operations. The Board of Supervisors and the Mayor work together to determine how to allocate this funding, and the capital for a municipal bank would compete against other pressing funding demands.³⁰ Of this \$2.2 billion, \$68 million went to the Office of Economic and Workforce Development (OEWD) which supports economic development and small business lending, and \$152 million went to MOHCD which supports affordable housing and economic development.³¹ Overall, the City

³⁰ Based on the City's Comprehensive Annual Financial Report (CAFR), there were discussions at the Task Force meetings and among advocates about whether the City was running a "surplus," and therefore has significant unallocated funds that could be used to capitalize a municipal bank. In short, aside from one or two funding sources currently held in case of an emergency, there is no unallocated money that could be used to capitalize a municipal bank. Discussions about unallocated funds centered around the funds listed in page 165, defined "Available for Appropriations," which includes "Unassigned Funds." For \$95 million in "Unassigned – General Reserve" was initially created to address current year needs unanticipated in the budget, and later was updated to augment the economic stabilization reserves. Admin Code § 10.60 governs the use of these reserves. If used, it must be replenished in the next year unless the City is a recession scenario. The Board can suspend this provision for one year by a 2/3 vote. The \$288 million "Unassigned – Budget for use in fiscal year 2018-2019" has already been allocated for 2018-2019 via the City's two-year budget process. Any money taken from this pool will cut current FY18-19 appropriations. The \$60 million in "Unassigned – Contingency for fiscal year 2017-2018" was adopted by the Board of Supervisors to address potential changes in federal impacts and ACA changes. \$50M remains available, though use of these funds would limit the City's ability to address a cut in coverage or repeal of the ACA. The \$14 million "Unassigned – Available for future appropriations" is the fund balance at the end of fiscal year 2016-2017. This money is projected to cover shortfalls and not available for appropriation. City and County of San Francisco, Office of Controller. (2017). Comprehensive Annual Financial Report Year ended June 30, 2017. Retrieved from: <https://sfcontroller.org/sites/default/files/Documents/Accounting/CCSF%20CAFR%20FY2016-17%20no%20cover%20FINAL%20reduced.compressed.pdf>.

³¹ The San Francisco Board of Supervisors. City and County of San Francisco Budget and Appropriation Ordinance Fiscal Year Ending June 30, 2019 and Fiscal Year Ending June 30, 2020. Retrieved from: <https://sfgov.legistar.com/View.ashx?M=F&ID=6406150&GUID=663AE469-8025-4FFB-B183-4157BA300C25>.

spends \$400 million on affordable housing per year, though some of this funding comes from non-discretionary sources (like the Housing Trust Fund).³²

Philanthropy

The bank could also seek out private philanthropic donations for capitalization. The major benefit is that philanthropic dollars need not come at the expense of other City priorities. It would be important to find mission-aligned philanthropic sources so that the bank could remain focused on community goals, and the philanthropic funding should not impact the bank's ability to be independent.

Crowdfunding

Lastly, the bank could use crowdfunding, soliciting money from the community to capitalize a bank. The most famous example of crowdfunding is the Green Bay Packers,³³ and the City could use several mechanisms to crowdfund capital from community investment. If the City accepts philanthropic money or crowdsourced money (or uses any third-party money aside from its own), it will need to create a bank holding company to own the bank. This additional level of regulatory structure may increase the costs and complexity of chartering a municipal bank.

Sources of Funds That Can't Be Used for Bank Capital

Bonds

The City cannot use a general obligation bond

issuance to capitalize a municipal bank because bonds are limited by the State Constitution to specific uses. Section 1(b) of Article XIII A of the California State Constitution limits the use of general obligation bonds to "the acquisition or improvement of real property."³⁴ Though a municipal bank may itself invest in real estate projects, the bond will be used for bank capital and would not qualify as "the acquisition or improvement of real property."

Pooled Investment Funds

The Treasurer's Pooled Investment Fund holds money that has already been appropriated in the budgetary process and is "not required for the immediate needs" of the City as well as money that belongs to other entities such as the San Francisco Unified School District and City College.³⁵ All of the funds have already been allocated through the budgetary process and through voter-initiated bond approvals and as part of the capital plan. The California Government Code sharply restricts the types of investment the Treasurer can make with the fund. All investments must be less than five years in duration and must be of the highest quality. State law does not permit the Treasurer to purchase or invest corporate stock,³⁶ and so the Treasurer currently may not use the Treasurer's Pooled Investment Fund to own corporate stock and capitalize a public bank.

Sources of Deposits

Aside from capitalization, a municipal bank also needs upwards of \$1 billion in deposits, and

32 The San Francisco Office of the Mayor. (August 2018). Mayor London Breed Signs Budget Targeting Homelessness, Housing, Street Cleanliness, and Public Safety [Press Release]. Retrieved from: <https://sfmayor.org/article/mayor-london-breed-signs-budget-targeting-homelessness-housing-street-cleanliness-and-public>.

33 The Green Bay Packers have been a publicly owned nonprofit corporation since 1923 and has raised capital by selling stock in five different offerings. Today, over 360,000 members of the public co-own the Green Bay Packers via common stock. This stock is not stock in a traditional sense: it does not increase in value; it does not pay dividends, and it cannot be resold (except back to the franchise). Saunders, L. (January 13, 2012). Are the Green Bay Packers the Worst Stock in America? Wall Street Journal. Retrieved from: <https://blogs.wsj.com/totalreturn/2012/01/13/are-the-green-bay-packers-the-worst-stock-in-america/>.

34 Cal. Const. art. XIII A, § 1(b).

35 California Government Code § 53601.

36 California Government Code § 53601; San Francisco City Attorney's Office (2013), Memorandum re: Municipal Bank Formation.

this funding could come from the City, private businesses, and large institutions.

City Funds

Deposits could come from a general fund appropriation, from the \$100 million the City currently holds in overnight deposits in Bank of America, or from the Treasurer's Pooled Investment Fund via certificates of deposit similar to the current Safe, Sound and Local Program. State law requires that government deposits be collateralized and limited to the amount of capital that the bank holds.³⁷ The \$100 million currently held in the Bank of America account are used daily to pay the City's obligations, and so the City must be able to rely on their availability and liquidity or else the City's financial well-being would be adversely impacted.

Other Institutions

The bank could also accept deposits from institutions such as other governments (though money may need to be collateralized), foundations, hospitals and universities, as these organizations may want to support the bank's mission. The bank could offer a reasonable return on accounts rather than retail services. Many mission-oriented local community banks note that they do not have any trouble attracting deposits, because consumers want a non-Wall Street alternative to hold their money. If the municipal bank does not offer retail services, though, the return to depositors may need to be higher than the one percent currently modeled.

How Should Bank Governance Be Structured?

The municipal bank ultimately exists to serve the City and taxpayers, and so the governance structure should likely include both government and citizen representation. However, it is equally crucial that a municipal bank operate as a sound business, independent from the political process and political pressures. The FDIC has expressly noted that applications from public banks will be examined closely because public banks present "unique supervisory concerns that do not exist with privately owned depository institutions."³⁸ Internationally, political pressure has reportedly impaired the operation of public banks.³⁹ A municipal bank in San Francisco may be similarly vulnerable to conflict between bank leadership and public figures. City government likely should not have a majority or a perceived majority of the bank governing body, and the rest of the board should be composed of well-respected, independent experts with a background in banking and finance.

Despite concerns regarding politics, it is important that the work of the municipal bank dovetail with the City's work and priorities. The City will likely be the primary investor in the bank, and the municipal bank exists to invest in the community and serve taxpayers. At times, the bank may need to partner with the City: for example, if the municipal bank is providing loans on an affordable housing project, it must ensure that the City has secured and can enforce the developer's commitment to affordability.

37 California Government Code § 53638; California Government Code § 53652.

38 The FDIC Statement of Policy states: "For example, because of their ultimate control by the political process, such institutions could raise special concerns relating to management stability, their business purpose, and their ability and willingness to raise capital (particularly in the form of true equity rather than governmental transfers)." Federal Deposit Insurance Corporation (1998). Statement of Policy on Applications for Deposit Insurance. Retrieved from: <https://www.fdic.gov/regulations/laws/rules/5000-3000.html>.

39 The head of Slovenia's publicly-owned bank, Nova Ljubljanska Banka (NLB), resigned in 2009 due to political interference, and his successor resigned a year later citing similar reasons. Similarly a study of public banks in 65 countries found that banks that experience political interference (defined as a change in bank executives after elections) have worse financial performance, though the impact is greater in developing countries. Beynet, P. (October 1, 2013). In Banking, Should There Be a 'Public Option'? Lessons from Slovenia's Public Banking Crisis. The New York Times. Retrieved from: <https://www.nytimes.com/roomfordebate/2013/10/01/should-states-operate-public-banks/lessons-from-slovenias-public-banking-crisis>; Shen, C. and Lin, C. (April 2012). Why government banks underperform: A political interference view. Journal of Financial Intermediation 21(2). Retrieved from: <https://www.sciencedirect.com/science/article/pii/S1042957311000271>.

The governance structure must not only balance political independence with potential City partnership, but also ensure the bank both turns a profit and remains true to its mission. As fiduciaries of the organization, the Board of Directors must act in the best interest of the bank and the shareholders. Even if the bank is structured as a benefit corporation, the Board must still require that the bank be fiscally prudent and on a path to sustainability. At the same time, the Board must ensure that the bank adheres to its mission and does not engage in mission creep or forgo the mission to pursue greater profitability. The governance structure and formation documents should include provisions to ensure that the bank can both achieve a surplus and operate prudently while simultaneously complying with its mission, but the conflict between pursuing profitability and social goals will likely remain throughout bank operations. Ultimately bank governance and leadership must fully accept this conflict and ensure that a commitment to both social good and fiscal sustainability is baked into the structure of the bank and that all bank stakeholders are committed to making the hard decisions necessary to ensure the bank's ongoing viability.

What Are the Tensions Between a Municipal Bank and the Treasurer's Role?

Per State law, a County Treasurer has one overriding priority: to ensure the funds in his or her custody remain secure and protected. This requirement applies equally strongly to the money held in the City's cash management accounts with Bank of America and the money held in securities in the Treasurer's Pooled Investment Fund. In 1994, Orange County filed for bankruptcy because of reckless investing by the County Treasurer. Because of this bankruptcy, county programs were cut,

services were reduced, and public employees lost their jobs. In the wake of the Orange County bankruptcy and to prevent a similar catastrophe in the future, very strict criteria were codified to govern how county treasurers can manage public funds. Per state law and the City's investment policy, the City's top priority must always be preserving the safety of the principal, followed by meeting liquidity needs, and only then receiving a reasonable yield. Further, county treasurers must require any depository entity provide collateralization of at least 105 percent. This is a critical safeguard of the public's money. Without collateralization, market fluctuations could risk the safety of taxpayer funds, and the City's ability to pay for vital services.

Ultimately, a county treasurer may only put money in a municipal bank if it meets the safety, liquidity and yield requirements mandated under state law. Many of the barriers to a municipal bank – collateralization of public deposits, limits on deposits to capital of the bank⁴⁰ – exist to protect the City's money. Money that is fully collateralized cannot be lost in the event of a bank failure. While public banks thrive around the world, bank failure is always a risk – for both public and private banks. The municipal banks modeled above may pose a higher risk of failure than traditional community banks or the Bank of North Dakota, because they plan to perform below-market lending to projects and individuals rejected by traditional banks. While a municipal bank would be governed and monitored by multiple regulators, the decision of whether a municipal bank is safe enough for the City's money is ultimately left up to the Treasurer. In investing and safeguarding the City's money, a county treasurer must act with the "care, skill, prudence, and diligence... that a prudent person" would use.⁴¹ The very thing that makes a municipal bank attractive to the City (filling gaps in service and reinvestment)

40 California Government Code § 53638; California Government Code § 53652.

41 California Government Code § 53600.3. Trustees covered by this rule include: "all governing bodies of local agencies or persons authorized to make investment decisions on behalf of those local agencies investing public funds." Id.

may conflict with the Treasurer's role and priority in safeguarding the funding. Given the high costs – if something goes wrong, taxpayers would lose their money and City services and employees could be impacted – it is crucial that the City ensure that a municipal bank's structure and lines of business align with a county treasurer's mandate.

What Are Other Options Aside from Creating a Municipal Bank?

Creating a municipal bank is a costly and time-intensive endeavor. Before deciding whether to create a municipal bank, the City could also consider alternative programs and policies that could serve similar aims as a municipal bank. Even if the City chooses to go forward and create a municipal bank, it will likely take at least three years to get a bank that is fully operational. In the interim, there are many opportunities for the City to achieve its goals. These initiatives and programs are aimed at various outcomes: socially responsible banking, small business lending and un- and underbanked individuals. Some of these programs involve some form of money transfer or lending but do not require the City to charter or operate a bank. They frequently take advantage of organizations and work that is already happening, facilitating lending rather than competing directly to make the loans. Opportunities are as follows:

Other Bank Options

Aside from Models One, Two and Three presented above, Task Force members had a number of ideas for other municipal bank structures. Though the Task Force and staff chose not to pursue an in-depth analysis of these models, the following section provides a brief overview of these models and potential costs as well as benefits of pursuing them.

- **Partner with a fintech to reduce bank costs:** Several members of the Task Force were interested in investigating opportunities for financial technology (fintech) companies to partner with the

bank and help drive down municipal bank costs, particularly the costs associated with performing the City's commercial banking. For example, Task Force members suggested that the bank could provide the front end of a municipal bank and utilize a fintech to provide the costly infrastructure and back-end of the bank. TTX staff met with and spoke to many fintechs operating in the Bay Area and around the country, seeking companies to collaborate with. In general, the fintechs that the City encountered were unable to accommodate our needs. Many were too small and lacked the ability to scale up. Others handled only electronic payments and did not have a cash solution, which is necessary given the high-volume of cash that the City handles on a daily basis. Lastly, banking staff were concerned about providing essential functions to a new and untested company or technology, as operational issues or glitches could impair City functioning and result in serious adverse outcomes like the City failing to make a bond payment or missing payroll. Despite these concerns, fintechs still offer significant promise and have the potential to revolutionize the banking industry. There may be existing fintech companies that could help a municipal bank serve as the City's banker in a more efficient and less costly manner. If the right company doesn't exist now, there certainly will be more opportunities in the future. The promise of fintechs suggest that IT costs for a municipal bank could decrease over time as technologies improve.

- **Acquire a local community bank:** Rather than create and charter a new bank, several Task Force members suggested that the City could acquire a local community bank. Acquiring a bank has several benefits. It eliminates the need for the City to create all the infrastructure for a bank, including acquiring FDIC insurance, a state charter, and information technology systems. Moreover, if the City were to acquire an existing bank, it would acquire the bank's

deposits and loan portfolio which could potentially hasten the path to profitability. On the other hand, a concern about acquiring a bank is that it may not be able to accomplish either divestment or reinvestment initially. A local community bank will not have the infrastructure to serve as the City's banker initially, and its loan portfolio likely will not match up to community goals. In fact, for some banks, their outstanding loans may be more of a liability than an asset, because these loans may be risky and not in line with the values of a municipal bank, potentially leaving the municipal bank in the uncomfortable situation of taking adverse action on problematic or predatory loans. However, over time, the bank could build the infrastructure necessary to serve as the City's commercial banker and evolve its loan portfolio to meet reinvestment goals. The cost to buy a bank will depend on a variety of factors: the size, assets, capitalization, facilities, projected revenue and IT infrastructure of the bank. In general, though, the City could expect to pay the net worth of the bank (capitalization) plus a premium (one expert put the premium at approximately 20 percent). There are significant due diligence and regulatory hurdles associated with buying a bank, and bank experts cautioned that acquiring a bank would not necessarily be faster than creating a new bank.

- **Create an investment bank:** Some members of the Task Force felt strongly that a municipal bank should focus more on infrastructure and underwrite the City's bond issuances. For some members this work would occur instead of commercial banking, whereas for others, the infrastructure lending and underwriting would occur in conjunction with commercial banking and lending. To

become a bond underwriter, the municipal bank would need to become an investment bank and a registered broker-dealer. It would need to hire staff that have expertise in capital markets and a sales channel to investors and who are willing to work for lower-pay for a municipal investment bank rather than a traditional investment bank. It would also have to meet a heavy compliance burden with thornier conflict-of-interest issues and may have to win bids to underwrite the City's bonds, depending on whether the City uses a competitive or negotiated process. Creating a municipal investment bank would allow the City to reduce or eliminate its reliance on Wall Street investment banks for its underwriting work and would reduce or eliminate the fees it currently pays to those banks. Underwriting bonds would bring in a source of revenue for the municipal bank – rates for underwriting vary from about 0.3 to 1 percent of total issuance in California.⁴² Having a municipal bank underwrite bonds, though, would still result in the City taking on debt to perform large municipal projects, and ultimately that debt would likely still be held by institutional investors and higher-income households.⁴³ Staff were unable to model the costs and benefits of the City creating an investment bank and performing its own underwriting because they did not have the background or expertise necessary.

- **Support efforts to create a state or regional public bank:** Members of the Task Force also suggested that the report include a model for a state-wide or regional public bank. In California, there are numerous proposals for state banks including the State Treasurer's feasibility study for a public bank serving the cannabis industry and a proposal to turn the State Infrastructure Bank (I-Bank) into a depository institution. A full financial

42 Schaefer, Tim (February 1, 2019). Personal interview; KNN Public Finance (October 22, 2013). Cost of Issuance [PowerPoint slides]. Retrieved from: <https://www.treasurer.ca.gov/cdiac/seminars/2013/20131022/day1/5.pdf>.

43 Municipal Securities Rulemaking Board (2018). Trends in Municipal Bond Ownership. Retrieved from: <http://www.msrb.org/msrb1/pdfs/MSRB-Brief-Trends-Bond-Ownership.pdf>.

model for a state or regional public bank is beyond the scope of this study. However, there likely would be numerous benefits to a state- or regional-level public bank that would help with the bank's scale, safety and impact. A bank that serves a larger area will likely be able to scale faster and become larger because it could aggregate deposits from numerous jurisdictions. The larger size of the bank would reduce its costs for performing certain work, through economies of scale, and would likely make it easier and cheaper to perform commercial banking for the City and other governmental clients. A bank with a broader geographic reach also would be less concentrated in a given area and could spread its lending activity out over a broader region, making it less vulnerable to local economic shocks. Lastly, a larger bank that serves a region or the state would have a greater overall impact on the economy. There are also some drawbacks associated with a regional or state bank. A regional or state bank would offer the City far less control over outcomes, and a regional bank may need to have a complicated governance structure to ensure all stakeholders are adequately represented. Nevertheless, many Task Force members felt strongly that a state or regional bank could best achieve the goals of the Task Force in an efficient manner.

Socially Responsible Banking

A major reason legislators and advocates are interested in a municipal bank is because there is a strong understanding that the current banking system is not beneficial for our City and its residents. There are numerous opportunities for the Treasurer to use his power to encourage, advocate and incentivize changes in the banking industry via the power of the purse and the bully pulpit without creating a municipal bank. These options include:

- **Expand socially responsible banking indicators in the City's banking RFP:** In 2011, the City was one of the first jurisdictions to include socially responsible

banking indicators in the City's banking RFP. This practice has spread across the country. The City should continue to include socially responsible banking and should increase its prominence in future RFPs and consider expanding the criteria to include a proactive requirement that the City's banking partners offer products and services or participate in City programs.

- **In-source mail and check processing from commercial banking partners:** Currently TTX performs some work like the City's commercial banking partners, including operating lockboxes which receive and process City payments. The City could investigate using TTX and other City staff to perform mail and check processing work and lockbox operations currently contracted to large commercial banks.
- **Continue to break up the City's banking RFP:** Breaking up the City's banking RFP allows smaller community banks and credit unions to bid on the opportunity to provide the City's banking services, potentially allowing the City to reduce its reliance on large Wall Street banks. In 2018, the City of Los Angeles requested responses to its RFP that would allow for its banking business to be broken into six relationships. The result of this RFP is still outstanding. In 2019, the City is removing two pieces of business from the Bank of America contract, which will reduce the fees by over \$300,000 per year. Moving forward, the City should consider opportunities to further break up its banking RFP to encourage bidding from smaller banks and credit unions whose values are more in-line with the City's.
- **Expand work on awareness regarding banks and consumer protection:** The Office of Financial Empowerment within TTX currently works with banks and advocates to create a financial system that works for all residents in our City. This work can be expanded to include a scoring mechanism to rate financial institutions and products, and potentially to create a mechanism to

collect, investigate and address consumer complaints.

- **Advocate for banking sector reforms:** Treasurer Cisneros has actively fought for reforms to the banking sector to help San Francisco residents. He battled check cashers and has encouraged local businesses to move towards direct deposit and other modern innovative payroll solutions, and he proactively took a stand against Wells Fargo after learning they engaged in widespread illegal practices. The Treasurer and the City as a whole should continue to advocate for banking sector reforms, using the power of the bully pulpit to fight unscrupulous and predatory behavior and to promote a more equitable and inclusive financial system.

Community Investment

Many Task Force members and advocates are interested in public banking for reinvestment – ways to see the City’s money leveraged for community goals. While a municipal bank can promote local community investment, there are also non-bank opportunities, such as:

- **Expand Safe, Sound and Local:** Safe, Sound and Local, which launched in October 2017, makes up to \$80 million per year of the County’s Pooled Investment Fund available for investments in banks, credit unions and CDFIs located in San Francisco that are backed by letters of credit issued by the Federal Home Loan Bank of San Francisco. TTX can continue to promote the program to increase participation, particularly by local CDFIs, and should investigate expanding the program.
- **Create non-bank lending programs:** The Board of Supervisors and the Mayor could consider appropriating funding and creating a community investment fund to perform lending in the San Francisco community.

Specifically, this lending vehicle could pursue the lines of business identified by the Task Force and staff such as loans for ADUs and LBE contractors. Other jurisdictions have created similar loan funds. For example, the Chicago City Council created a \$100 million Chicago Community Catalyst Fund to invest in small business and real estate development in low-to-moderate income communities via a fund-to-fund model.⁴⁴ Similarly, Vermont created the Local Investment Advisory Committee to perform local lending in infrastructure, renewable energy, energy efficiency and housing, and the state legislature authorized the Treasurer to use up to ten percent of the state’s average daily cash balance (of \$330 million) to perform local investments.⁴⁵

Small Business Lending

Aside from general community investment, Task Force members and members of the public wanted a municipal bank to support small businesses and promote small business lending. Some interim solutions include:

- **Sign on to the Small Business Borrowers’ Bill of Rights:** The Responsible Business Lending Coalition, a network of for-profit and non-profit lenders, brokers and small business advocates has created a six-point bill of rights for small business borrowers. The City could also become a signatory, joining organizations like Accion, Pacific Community Ventures, and the National League of Cities.
- **Better publicize existing small business lending programs and CDFIs:** San Francisco is home to a robust ecosystem of small business support programs and lenders, such as CDFIs. The City can work to better publicize existing lending programs and CDFIs and potentially explore the

44 Matuszak, P. (July 5, 2017). Chicago commits \$100 million to investment fund aimed at low-income areas. Chicago Tribune. Retrieved from: <https://www.chicagotribune.com/news/ct-chicago-catalyst-fund-met-20170704-story.html>.

45 State of Vermont Office of the State Treasurer (January 5, 2018). Local Investment Advisory Committee (LIAC) Report. Retrieved from: https://www.vermonttreasurer.gov/sites/treasurer/files/cash-investments/local-investment-advisory-committee/supporting-materials/LIAC_FINAL2018_Report.pdf.

creation of a small business lending/CDFI matching program to allow small businesses to determine which CDFI may best fit their needs.

- **Research opportunities to improve access to credit for cannabis equity businesses:** Because of federal law restrictions, banks and CDFIs will not serve cannabis businesses, which can then only access debt via family and friends and private placement like venture capital funding. Cannabis equity entrepreneurs rarely have access to capital from these sources. To help make the equity program a success, the City can work to expand access to credit for equity cannabis businesses and investigate other opportunities to support these businesses.

Un- and Underbanked Residents

While no municipal bank models addressed un- and underbanked residents, members of the Task Force and the public indicated that serving this community was a high priority. These interim solutions build on existing work being done in the City to serve this vulnerable population, including:

- **Promote and expand the Bank On Program:** Bank On San Francisco, a ground-breaking program launched in 2006, helps unbanked San Franciscans get access to low-cost checking accounts and has been replicated across the country through the Bank On national program. The Office of Financial Empowerment should continue to promote and expand the program to ensure that it is reaching more unbanked San Franciscans.
- **Advocate for youth bank accounts:** Through Summer Jobs Connect, the Office of Financial Empowerment works to get youth access to appropriate, non-custodial accounts at local banks and credit unions. The City should continue to advocate for non-custodial youth bank accounts and expand the number of local banks and credit unions offering these accounts and working with youth. City departments should

also ensure that all youth taking part in their employment programming have the opportunity to access a safe and secure bank account that will start them on the path to financial stability.

- **Expand Smart Money Coaching efforts:** The Office of Financial Empowerment runs Smart Money Coaching programming with local non-profits, offering free one-on-one financial coaching to help people reduce debt, save, and establish or improve their credit scores. The City should expand this program to offer it to more City residents and to ensure that everyone who wants to opportunity to meet with a coach is able to do so.
- **Research opportunities to bring non-predatory small-dollar loans to employees in San Francisco:** The City should investigate opportunities to work with third-party providers to offer a payday-loan alternative such as an employer-based, non-predatory small-dollar loan to employees. The City should first push to offer this service to City employees via a pilot program, and then if that is successful should advertise and promote it as an opportunity for other large employers in San Francisco.
- **Investigate options to provide small grants:** Rather than create or promote an employer-based small dollar loan program, the City could simply choose to offer small grants to people without expecting any repayment. The City already does this in some instances, for example, offering financial assistance to individuals facing eviction or seeking a security deposit.

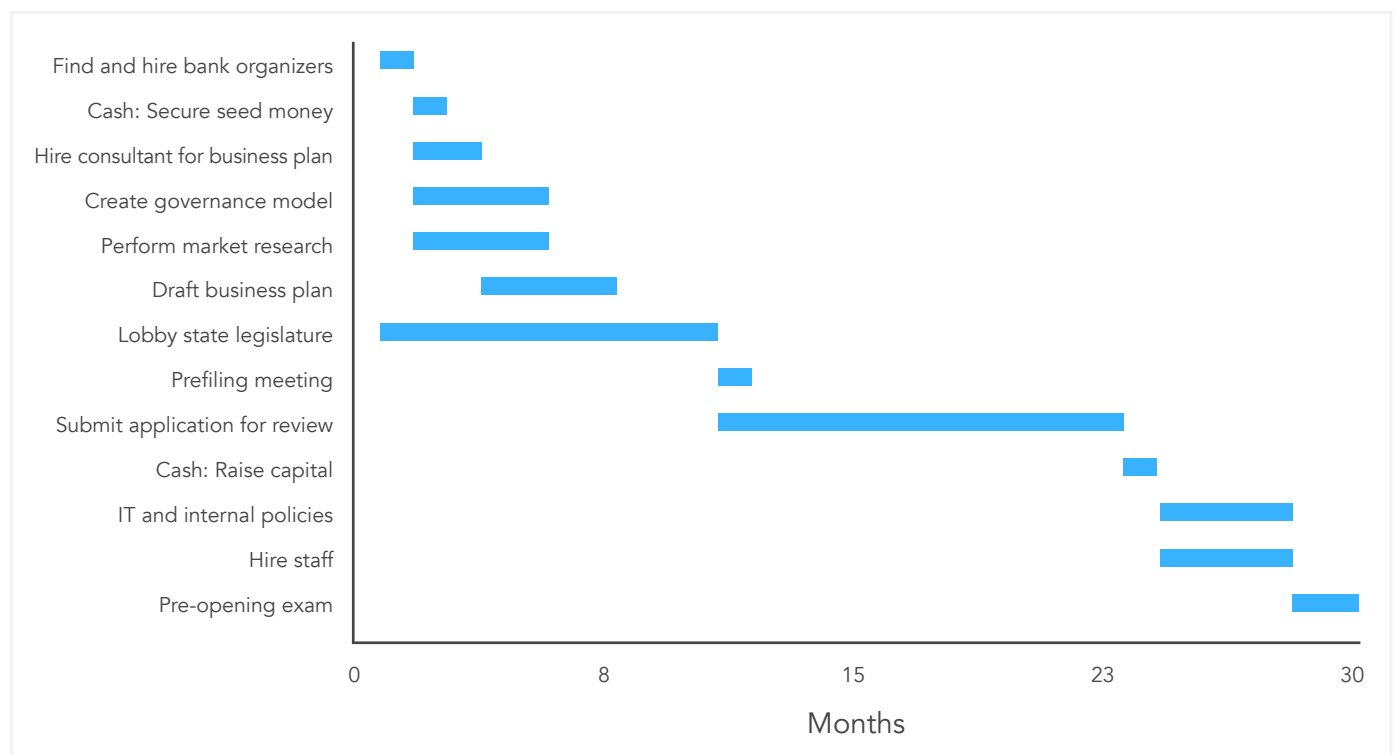
Conclusion: A Phased Approach and Next Steps

The primary goals behind creating a municipal bank are to divest from Wall Street banks and reinvest in the community. The bank models analyzed show that these goals may be met after decades of significant investment in start-up, capitalization and operational subsidies. After this time, the banks could achieve sustainability and no longer operate at a loss. At scale, a reinvestment bank could funnel millions, and potentially billions, into affordable housing and small business lending, and a divestment bank would ensure that the City could perform its own commercial banking and does not have to rely on Wall Street for its commercial banking services.

The decision about whether to create a municipal bank is a policy matter that rests with the Board of Supervisors and the Mayor. When deciding next steps, the City has many options and decisions ahead – both in terms of whether to create a municipal bank and what form that municipal could and should take. An option to highlight is the opportunity for a phased approach, where the City implements interim opportunities while a municipal bank is in development, and then allows the bank itself to develop over time.

A phased approach could offer a logical and efficient progression and pursuing interim programs will help a municipal bank succeed. Most banking experts suggest it will take at least two years to receive a banking charter and stand-up a bank. The process may be even longer – perhaps even 3 to 5 years – given the novelty of a municipal bank, and the likelihood that the bank will have a less traditional business plan. Additionally, before the City can even apply for a bank charter, it will need to lobby the state for legislative changes, create a governance plan, hire bank organizers, and draft and finalize a business plan.

Figure 4: Approximate Timeline for Municipal Bank Start-Up Tasks



To avoid delay and losing momentum, the City could start developing and implementing non-bank lending programs in the interim while the municipal bank is in development. These lending programs could help the City achieve its community goals, develop expertise and build a solid track record and book of business that could eventually transition to a municipal bank once it is chartered. The City could begin with a simple program, like purchasing participation loans, because such a program does not require underwriting or direct lending expertise. Over time, the City could increase the complexity of its lending programs, creating direct lending initiatives which require underwriting, originating and servicing. Some of these programs may require the City to apply for a commercial lending license and establish a separate entity.

Aside from creating momentum, a major benefit of a phased approach is that it allows the City to build up a book of business for a municipal

bank. A solid track record of lending could provide the City with credibility when it applies for a bank charter, and equally important, it could help a municipal bank reach profitability more quickly. Banks are typically unprofitable initially because they do not have much lending business bringing in income. Over time as they build up their business, they bring in more money. If a municipal bank already has loans on its books from a prior lending program, its path to profitability may be shorter, and it may need less operational subsidies to cover initial losses. In this manner, short-term investments in lending programs can lead to long-term dividends for a municipal bank and the City.

Though the exact timing and phases are ultimately a decision for the Board of Supervisors, the following figure provides an approximation of what a phased approach could look like:

Figure 5: Potential Plan for Phased Approach to Municipal Banking

Year 1	Year 2-4	Year 5+
<ul style="list-style-type: none"> • Establish low-cost financial programs, e.g. purchasing participation loans • Finalize public bank deposits, capital and lines of business, and create business plan • Enact state legislative changes, e.g. public bank charter 	<ul style="list-style-type: none"> • Establish more involved financial programs, e.g. requiring establishing loan underwriting capabilities • Establish applicable non-bank financial entities and begin lending • Apply to relevant regulators for bank charter and deposit insurance 	<ul style="list-style-type: none"> • Establish a bank

Once a municipal bank is chartered and operational, the bank itself could develop and expand in phases. Many banks evolve, growing and raising additional capital over time. One option is for the bank to begin with a more conservative lending portfolio – perhaps just participation lending as in the divestment Model Two. Over time, as the bank achieves sustainability, it can expand its offerings into affordable housing lending and wholesale small business lending. Eventually it could branch out

into higher-risk loans or offer retail services.

Ultimately, if the City chooses to pursue either Model One, Two or Three, the bank would require significant investment until it breaks even. Between start-up costs, operational subsidy (to keep the bank afloat) and capital, Model One would require \$184 million; Model Two would require \$1.6 billion, and Model Three needs \$3.9 billion in investment.

Table 17: Average Investment Required for Municipal Bank Models to Break Even

	Model One: Reinvest	Model Two: Divest	Model Three: Combination
Break Even Details			
Years to Break Even	10	31	56
Size at Breakeven	\$1.1 billion	\$3.1 billion	\$10.4 billion
Estimated Appropriation Required to Break Even			
Start-Up Costs	\$6 million	\$119 million	\$119 million
Operational Subsidy	\$13 million	\$990 million	\$2.2 billion
Capital Investment	\$165 million	\$460 million	\$1.6 billion
Total	\$184 million	\$1.6 billion	\$3.9 billion

Next steps:

The goal of this report is to provide enough analysis regarding the costs and results of a municipal bank, as well as interim solutions, to allow the Board of Supervisors and the Mayor to decide whether they wish to move forward with a municipal bank. Assuming the consensus is to move forward with a municipal bank, the following -- in addition to the analysis put forth by the San Francisco Budget & Legislative Analyst’s office – can be used as a rough outline of next steps the City could take:

Create a working group to finalize objectives and build a roadmap: The goal of this Task Force was to determine the feasibility of the City creating a municipal bank and to investigate

what that bank could look like. As this report serves as the culmination of that work, the City should transition away from the Task Force and create a new working group of internal City actors to lead the next phase of work. The working group should finalize objectives for the municipal bank and build a realistic roadmap for creating a public bank. This working group could continue to guide the City throughout the chartering process.

Convene City agencies performing lending work: To help guide the working group’s process, the City should convene all the various City departments doing lending and community development work to share lessons learned and discuss current gaps and areas for improvement.

Departments should evaluate which programs could and should be expanded and discuss opportunities for a phased approach. The convening could result in requests for additional appropriations to support the expanded work.

Lobby for and enact change to state law to create a public bank charter: Currently state law does not include a charter for a public bank, only a commercial bank or credit union charter. This lack of a charter would make it more difficult for the public bank to receive a banking charter and operate. The City should work with its state delegation to lobby for and enact legislation to create a public bank charter.

Develop governance structure, hire bank organizers and create a leadership team: A bank must have the governance structure, bank organizers and proposed leadership team in place prior to submitting the business plan and application for FDIC insurance and a bank charter. The application for a California bank charter requires information regarding proposed directors and executive officers, including detailed biographical and financial information. The City should develop a governance structure that both limits political interference and also ensures that community perspectives and voices are included. In creating a leadership team, the City must find individuals who have significant banking and financial experience as well as an understanding of the bank's goals. Numerous experts in chartering new banks noted that it was crucial that the bank leadership team have experience in the roles that they would serve in a municipal bank. The proposed directors and executive officers should all be excited by the mission of the municipal bank and ready for the challenge of embarking on a new endeavor.

Meet with regulators to discuss municipal bank model: A municipal bank is a novel concept and San Francisco's municipal bank would likely have a non-traditional business

model. Accordingly, the City should engage with state and federal regulators early in the process of drafting a business plan to ensure that regulators are onboard with the initiative and comfortable with the structure, governance and business model of the municipal bank.

Hire a consultant to develop and draft the bank's business plan: A new bank's business plan is the primary part of an application for a bank charter or FDIC insurance. A bank's business plan must be comprehensive and reflect in-depth planning. The FDIC explains that a plan should "realistically forecast market demand, customer base, competition, and economic conditions," and also "reflect sound banking principles and demonstrate realistic assessment of risk."⁴⁷ A bank that will have a special focus or purpose must provide more detail about that feature. There are several consulting companies who focus primarily on advising de novo banks and creating business plans for banks. The City should procure for and hire a consultant to help develop and draft the bank's business plan.

Work with experts in areas the bank will focus on: Throughout this application process, the City should remain connected with experts who currently work in the areas of the bank's focus. Banking is an ever-evolving field, and it is important that the municipal bank stay aware of changes in the field as well as economic conditions that may affect the bank's eventual operations.

Continue to use the City's purchasing power and bully pulpit to push for changes in the banking industry: One of the main rationales for creating a municipal bank is to create an alternative to the traditional banking industry, which is viewed as harmful and unresponsive to citizens. While the municipal bank is being created, the City should continue to use alternative means to push for changes

47 Federal Deposit Insurance (December 10, 2001). Business Plan Guidelines. Retrieved from: <https://www.fdic.gov/news/news/press/2001/pr-form2.html>.

in the banking industry. The City can use its purchasing power to promote better banking practices. For example, in procuring a new bank for the City, the Treasurer can require that bidders provide information about their practices and also promise to offer specific products and services should they receive the contract. Similarly, the City, through the Office of Financial Empowerment, can continue to implement innovative programs such as Bank On and Smart Money Coaching which help underserved citizens get access to the banking system. Lastly, the City can use its bully pulpit to advocate for changes in the banking system and for legislation that will make the banking system fairer, more responsive and more accessible for all San Franciscans.